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DIRECTORS' LIABILITY FOR CORPORATE FAULTS AND DEFAULTS—AN INTERNATIONAL COMPARISON

Dr. Helen Anderson*

Abstract: Australia's new Rudd Government has indicated to business leaders that it intends to review various aspects of corporate law, including the imposition of personal liability on directors for corporate fault. Their concern is that the present corporate law regime is causing directors to be overly cautious in making decisions, to the detriment of the efficient operation of companies and the well-being of our economy. At the same time, the government acknowledges the importance of imposing appropriate sanctions where a company or its officers fail to meet required standards. These are universal concerns. To inform this debate, this article will look at the way in which key aspects of corporate law are dealt with internationally, and outline some reasons for convergence and divergence.

I. INTRODUCTION

Directors' liability is a contentious area, and much has been written on the subject of whether directors should be personally liable for corporate faults and defaults.¹ The new Australian government's stated aim² is to

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¹ A small selection of these include: Andrew Keay, *Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors*, 66 MOD. L. REV. 665 (2003); Rizwaan Mokhal, *On Fairness and Efficiency*, 66 MOD. L. REV. 452 (2003); David Wishart, *Models and Theories of Directors' Duties to Creditors*, 14 N. Z. UNIVERSITIES L. REV. 323 (1991); Ross Grantham, *Directors' Duties and Insolvent Companies*, 54 MOD. L. REV. 576 (1991); Judith Freedman, *Limited Liability: Large Company Theory and Small Firms*, 63 MOD. L. REV. 317 (2000); Jonathan Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189 (2003); Mark Van der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27 (1996); Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L. J. 117 (1980); Len Sealy, *Directors' "Wider" Responsibilities—Problems Conceptual, Practical and Procedural*, 13 MONASH U. L. REV. 164 (1987); David Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company*, 51 OKLA. L. REV. 427 (1998).

² See Dr. Ken Henry, Keynote Address to ASIC Summer School, Melbourne (Feb. 19, 2008), available at http://www.treasury.gov.au/documents/1346/HTML/docshell.asp?URL=Ministers_Speech_to ASIC_Summer_School.htm. Dr. Henry is the Secretary to the Australian Treasury, and gave this speech on behalf of The Hon. Nick Sherry, Minister for Superannuation and Corporate Law.

review the matter to determine whether liability is imposed appropriately and effectively.

The aim of this article is to show ways in which other countries deal with some of the corporate law problems which Australia faces. This article does not seek to analyse these laws to conclude that they are superior or inferior to the Australian ones. It has three objectives. First, it highlights the diversity of directors' liability law internationally, and makes and illustrates two simple but often overlooked points—first, that there is more than one way in which a regulatory objective can be achieved, and second, that some economies appear to function perfectly well without any law at all on a particular matter where such law seems essential elsewhere.

One might assume in this era of globalization that there would be greater uniformity. Perhaps it is not surprising that emerging economies such as China and South Korea do not have the same body of law as the Commonwealth jurisdictions. But it is remarkable to find that Canada has stringent laws imposing liability on directors for unpaid wages of employees but not for trading insolvently, whereas the United Kingdom is the direct opposite.³ The United States lacks both and Australia has both.⁴ Nonetheless, there are areas of the law where there is a considerable degree of similarity.⁵

The article's second objective is to show that where there is a legislative will to impose stringent liability on directors, it can be done, and has been done, in fairly harsh terms and in a variety of political and economic climates. This serves to discount the suggestion that governments should not legislate to impose onerous liability on directors, because it will result in suitable businesspeople being reluctant to take directorships or will make them overly risk-averse, to the detriment of economic growth, when holding such positions.

This point goes to the issue of why liability is imposed at all. In simplistic terms it is imposed to deter acknowledged forms of undesirable conduct and to compensate parties adversely affected by the behavior in question. Yet all parties adversely affected by undesirable conduct on the part of directors are not given the same rights of redress, and more remarkably for the purpose of this article, this unequal treatment is repeated in many jurisdictions. The international overview conducted by this article leads to the article's third objective, which is to suggest that there is some degree of correlation between the protection of powerful corporate

³ This liability is called wrongful trading in the United Kingdom. *See infra* Part III.A and III.B.

⁴ *See infra* Part III.A and III.B.

⁵ *See infra* Part II.

stakeholders, the strictness of laws to protect these stakeholders, and the similarity of those laws across the jurisdictions selected for examination. Conversely, the protection of vulnerable stakeholder groups is done through case law and legislation which is both diverse and generally lenient.

This article is divided into Parts. Part II gives some examples of similarity of laws, although even in such cases, there is no generally accepted template for their format or even adoption across all the jurisdictions surveyed. While many areas of director liability could have been looked at, three areas—capital raising, unremitted employee tax deductions, and protection of the environment—have been chosen to demonstrate the objectives outlined above. These neatly illustrate the way in which powerful but different cohorts of corporate stakeholders—investors, the government, and a vocal and well-supported lobby group—are protected by the law.

Part III then looks at some instances of diversity of laws. These have been chosen because they show the treatment of particularly vulnerable stakeholder groups. The Part begins with insolvent trading, where there are considerable differences among countries. Next, it looks at the protection of employee entitlements, where many countries have not legislated at all. Finally, it concludes with the tortious liability of directors *qua* directors, where the law is unsettled and contentious even within jurisdictions.

A wide variety of countries is surveyed to get a broad overview of the international picture. While they are countries from many parts of the world, no claims are made that they are typical or representative of their geographical region or their form of government. In addition, the article does not profess to have captured all forms of legislation possible.

Inevitably, the question arises—why have some jurisdictions found it necessary to impose liability in certain situations and in certain ways, where other jurisdictions apparently function well with different laws or no law at all? Part IV speculates as to what these reasons might be. While it is beyond the scope of this article to try to answer this definitively, the article reflects upon some possible reasons for similarity and diversity. Part V concludes the article.

II. SIMILARITY IN DIRECTORS' LIABILITY LAWS BETWEEN JURISDICTIONS

This Part examines three areas of the law which show marked similarities across the jurisdictions selected. As noted in the introduction, a number of different areas could have been chosen to illustrate the point. Capital raising, recovery of unremitted taxation installments, and protection

of the environment were selected because they represent a range of powerful stakeholder interests. What is noteworthy from an examination of the legislation governing these areas across the jurisdictions surveyed is the stringency of the laws and the degrees to which they adopt a common form of words and structure.

A. *Similarities in Capital Raising Laws Across Selected Jurisdictions*

Raising money is an essential operation for companies, and ensuring investor confidence in the process has become a key aspect of most jurisdictions' corporate legislation. The information on which the fundraising bid is based comes from directors and other corporate officers and experts. Substantial losses can be caused to investors and damage to market confidence in general if funds are raised based on false or misleading information, or incomplete information. It is this necessity for financing that makes prospective investors powerful corporate stakeholders who can demand considerable legislative protection.

As a result, most jurisdictions around the world, regardless of the form of their economy or government, require companies to issue prospectuses or other disclosure documentation to raise funds from the public. Legislation imposes liability on parties, including directors, for errors in, or omissions from, that documentation, subject to a similar range of defences. Liability is relatively harsh. One of the reasons for the degree of similarity could be that countries want access to the international market for capital. Stringent and familiar-looking liability laws give confidence to investors seeking to expand into an international location.

Australia⁶ has long had laws dealing with capital raising and imposing liability on directors for misleading statements in relation to the offering of securities.⁷ To prevent the inclusion of misleading information in the offer and issue of securities by public companies, the Corporations Act 2001 contains extensive provisions for the public disclosure of information.⁸ The offer must be made via a disclosure document⁹ in the form of a prospectus,

⁶ See Karen Wheelwright, *Australia*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁷ See, e.g., Securities Industry Code, 1981, § 107 (Austl.) (effective July 1981).

⁸ Corporations Act, 2001, §§ 710-716 (Austl.).

⁹ *Id.* § 710 ("A prospectus for a body's securities must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of the matters set out in the table below."). In relation to an offer to issue shares, the matters to be disclosed under that section include "the rights and liabilities attaching to the securities offered; the assets and liabilities, financial position and performance, profits and losses and prospects of the body that is to issue (or issued) the shares, debentures or interests."

an offer information statement or a profile statement,¹⁰ and must not include a misleading or deceptive statement¹¹ or fail to include specified information.¹² Section 729 contains a table outlining the parties who may be liable to those who suffered loss.¹³ This table includes directors, whether or not they committed or were involved in the contravention, although defences are available.¹⁴ In addition, the purchaser of the security may return it for a refund, and if this is not forthcoming from the company, the directors are personally liable for this amount.¹⁵ There are also criminal penalties applicable.¹⁶

By contrast, in Canada,¹⁷ another federal jurisdiction, there is no federal securities law statute.¹⁸ There are, however, provincial and territorial securities laws in Canada which impose particular obligations on directors of publicly traded corporations. In Ontario, for example, under the Ontario Securities Act (1990), a purchaser of securities has the right to seek damages from directors where the plaintiff can establish there was a misrepresentation.¹⁹ This right exists, regardless of whether the purchaser relied on the misrepresentation.²⁰ Directors are jointly and severally liable.²¹ Defences available include due diligence,²² knowledge by the plaintiff of the misrepresentation which did not therefore cause loss,²³ reasonable grounds

¹⁰ *Id.* § 709(4). An offer information statement, instead of a prospectus, can be used for capital raisings of \$10 million or less. Profile statements are governed by § 709(2).

¹¹ *Id.* § 728(1).

¹² *See id.* §§ 710-15.

¹³ *Id.* § 729.

¹⁴ *See, e.g., id.* § 731 (due diligence, which is proved by forming a belief on reasonable grounds after making reasonable enquiries); § 732 (lack of knowledge, which is available only in relation to offer information statements and profile statements); § 733 (reasonable reliance upon information from someone other than an employee or agent, where the director caused all due enquiries to be made; this defence is available for all disclosure documents).

¹⁵ *Id.* § 737(3).

¹⁶ *See id.* § 1311, § 1483 (Schedule 3).

¹⁷ *See Janis Sarra, Canada, in DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

¹⁸ There are 13 jurisdictions in Canada, as well as a federal jurisdiction. *See* Canadian Legal Information Institute, <http://www.canlii.org/en/ca/>.

¹⁹ Securities Act, R.S.O., ch. S-5, § 130(1)(c) (1990) (Can.) (Ont.). Under § 1(1) of this Act, "misrepresentation" means (a) an untrue statement of material fact, or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made."

²⁰ *See id.* § 130(1).

²¹ *Id.* § 130(8).

²² *See id.* § 130(3), (5).

²³ *See id.* § 130(2), (7).

for believing an expert's opinion,²⁴ or lack of consent or withdrawal of consent to the filing of the prospectus.²⁵

In addition, four provinces in Canada²⁶ have now enacted a statutory civil liability regime for misrepresentation or failure to disclose to secondary market participants. These provisions give secondary market investors a right of action against issuers and key related persons in relation to public misrepresentations or material omissions as required by securities law. Secondary market participants claiming under these provisions need only to show that they acquired or disposed of the company's securities during the period between the time the misrepresentation or omission occurred and the time that it was corrected.²⁷

In New Zealand,²⁸ capital raising is regulated by its Securities Act of 1978. A registered prospectus is required for securities offerings to the public,²⁹ failing which the offer is rendered void and the amounts subscribed must be repaid.³⁰ Joint and several liability may be imposed on directors where these repayments are not made,³¹ although a defence is available to the director upon proof of lack of personal default or negligence.³² Civil liability, in the form of compensation orders³³ or pecuniary penalties,³⁴ is provided for in relation to untrue statements in advertisements and registered prospectuses. Subscribers may apply for compensation orders if they subscribed "on the faith of an advertisement or registered prospectus that includes an untrue statement, for the loss or damage that the persons have sustained by reason of the untrue statement."³⁵ Defences are available under

²⁴ *Id.* § 130(3)(c).

²⁵ *Id.* § 130(3)(a), (b).

²⁶ See Securities Act, R.S.O., ch. S-5 (1990) (Can.) (Ont.); Securities Act, R.S.A., ch. S-4, Part 17.01 (2006) (Can.) (Alta.); Securities Act, R.S.M., ch. 18 (1987) (Can.) (Man.); Securities Act, c.S-42.2, Part XVIII, (1988) (Can.) (Sask.).

²⁷ Securities Act, R.S.O., ch. S-5, § 138.5 (1990) (Can.) (Ont.); Securities Act, R.S.A., ch. S-4, Part 17.01, § 211.05 (2006) (Can.) (Alta.); Securities Act, R.S.M., ch. 18, § 188(1) (1987) (Can.) (Man.); Securities Act, c.S-42.2, Part XVIII, § 136.21(1) (1988) (Can.) (Sask.). Other features of the new legislation include a reverse burden of proof in relation to misrepresentations in "core" documents and proportional liability in certain circumstances.

²⁸ See Chris Noonan & Susan Watson, *New Zealand, in DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

²⁹ Securities Act 1978, 1978 S.N.Z. No. 103, § 37 (N.Z.) (as amended).

³⁰ *Id.* § 37(5).

³¹ *Id.* § 37(6).

³² See, e.g., *Alexander v. De Lacy*, [1992] 6 N.Z.C.L.C. 68,020 (H.C.); *Reuhman v. Paape*, [2002] 9 N.Z.C.L.C. 262,988 (C.A.); *Robinson v. Tait*, [2001] 2 N.Z.L.R.30 (C.A.).

³³ Securities Act 1978, 1978 S.N.Z. No. 103 § 55G (N.Z.) (as amended).

³⁴ *Id.* § 55C.

³⁵ *Id.* § 55G(1).

§ 56.³⁶ Directors may also be criminally liable pursuant to § 58(1) of the Securities Act of 1978.³⁷

China³⁸ has had a long-standing problem with false statements, misleading disclosure and market manipulation,³⁹ and has recently made significant improvements to the legislation dealing with these matters. Companies listed on stock exchanges in China are prohibited from including false or misleading information or omitting material information in disclosure documents.⁴⁰ Recent amendments have strengthened civil, administrative, and criminal liabilities against persons who contravene statutory provisions dealing with false statements.⁴¹

While the emphasis has been on punishment rather than compensation of parties affected by the conduct,⁴² investors' actions against directors who have been administratively sanctioned or found liable in a criminal proceeding are allowed by the Supreme People's Court Rules.⁴³ The liability imposed on directors, which is joint with the company, is based on personal fault.⁴⁴ Examples of such fault include where they participate in making false statements, or know or ought to know about the false statement but do not act to prevent its publication.⁴⁵

South Africa⁴⁶ has both criminal and civil provisions dealing with disclosure when shares are offered to the public.⁴⁷ A director is liable to compensate persons who relied on the prospectus and acquired shares.⁴⁸

³⁶ *Id.* § 56. These include the absence or withdrawal of consent to be a director or to the distribution or registration of the advertisement or prospectus, or reasonable grounds to believe that statements made on the authority of an expert or in a public officials document were true.

³⁷ *Id.* § 58(1).

³⁸ See Chenxia Shi & Hu Bin, *China*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

³⁹ See Zhiwu Chen, *Capital Markets and Legal Development: The China Case*, 14 *CHINA ECON. REV.* 451, 459-64 (2003).

⁴⁰ See Securities Law, ch. 3 (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (P.R.C.) [hereinafter P.R.C. Securities Law].

⁴¹ See *id.* art. 69; Company Law, art. 150, 153 (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (P.R.C.); Amendments to the Criminal Law, art. V (promulgated by the Standing Comm. Nat'l People's Cong., June 26, 2006, effective June 26, 2006) (P.R.C.).

⁴² See P.R.C. Securities Law, art. 191, 193.

⁴³ Supreme People's Court Rules, arts. 26, 27, 28 (P.R.C.).

⁴⁴ Supreme People's Court Rules, arts. 21, 22, 23, 24 25 (P.R.C.).

⁴⁵ Liability is also extended to situations where directors should assume responsibility for the false statement and its effects. See Supreme People's Court Rules, art. 28 (P.R.C.); P.R.C. Securities Law, art. 63; see also Z. Cui and M. Ma, *Directors' Liability to Shareholders in Cases Concerning False Statements*, 2 *CHINA LEGAL STUD.* 96 (2003).

⁴⁶ See Kathleen van der Linde, *South Africa*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁴⁷ See Companies Act 61 of 1973 ch. VI. (S. Afr.).

⁴⁸ *Id.* § 160(2).

Liability is strict,⁴⁹ but a series of defences apply.⁵⁰ Where the company fails to refund moneys to investors who have not received the minimum subscription⁵¹ or where a condition that shares would be listed has not been fulfilled,⁵² directors are criminally and civilly liable. However, in these cases, there is a defence to both civil and criminal liability where the director can prove an absence of misconduct or negligence.⁵³

Under Hong Kong's⁵⁴ Companies Ordinance⁵⁵ "where a company allots . . . any shares in or debentures of the company with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made shall for all purposes be deemed to be a prospectus."⁵⁶ Requirements are set out in § 38.⁵⁷ According to § 41A (a), "a statement included in a prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included."⁵⁸ Under § 40, directors "shall be liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospectus for the loss or damage they may have sustained by reason of any untrue statement included therein," subject to defences set out § 40(2).⁵⁹ Criminal penalties also apply, subject to defences.⁶⁰ In addition, § 108 of the Securities and Futures Ordinance provides for civil liability where "a person makes any fraudulent misrepresentation, reckless misrepresentation or negligent misrepresentation by which another person is induced to invest in securities or other forms of regulated investments."⁶¹

⁴⁹ See *id.* § 160(1)(a)-(b).

⁵⁰ See *id.* § 160(3)(a)-(c), § 162(3)(a)-(c) (providing civil and criminal defences if the director reasonably believed in the accuracy of the information in the prospectus); § 160(3)(c)(ii)-(iii), § 162(4)(b)-(c) (providing civil and criminal defences if the director did not consent to the issuance of the prospectus and, upon learning that the prospectus was issued without their consent, gave reasonable public notice of this fact, or that, after that consented to the issue of the prospectus, upon becoming aware that it contained an untrue statement, they withdrew their consent and gave reasonable public notice of the withdrawal and the reason therefore).

⁵¹ *Id.* § 165(5)-(6).

⁵² *Id.* § 169(4)(b) and (5)(a).

⁵³ *Id.* § 165(5)(b) and § 169(5)(b).

⁵⁴ See Say H. Goo et al., *Hong Kong, in DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁵⁵ Companies Ordinance, (1990) Cap. 32. (H.K.).

⁵⁶ *Id.* § 41(1).

⁵⁷ *Id.* § 38.

⁵⁸ *Id.* § 41.

⁵⁹ *Id.* § 40(1)(a), 40(2). Defences include withdrawal of consent, reasonable grounds for belief that the statement was true, reliance on experts whose competence they had no grounds to doubt, and reliance on public documents.

⁶⁰ *Id.* § 40A, sched. 12.

⁶¹ Securities and Futures Ordinance, (2003) Cap. 571 § 108. (H.K.).

The United States of America enacted the Securities Act of 1933 as a result of the market crash of 1929.⁶² The legislation's two main goals were to ensure more transparency in financial statements so investors could make informed decisions about investments, and to establish laws against misrepresentation and fraudulent activities in the securities markets.⁶³ Section 11(a)(2) of the Act provides for the liability of directors to acquirers of securities for untrue statements or material omissions in registration statements. Defences are available under § 11(b), including resignation from the role, lack of knowledge about the registration statement, and reasonable belief in the opinion of experts.

In Malaysia,⁶⁴ capital raising and disclosure of information is now regulated by the Capital Markets and Services Act (2007).⁶⁵ Prospectuses must be registered⁶⁶ and contain specified information.⁶⁷ Pursuant to § 246, it is an offense for a person to "authorise or cause the issue of prospectus"⁶⁸ which contains any statement or information that is false or misleading or which omits material information, violation of which is punishable by fine or imprisonment. Civil compensation is available but only where the investors' loss has been caused by reliance on the prospectus.⁶⁹ Defences include due diligence,⁷⁰ reasonable reliance on another person such as a competent person,⁷¹ and lack of consent,⁷² although the latter is arguably superfluous, as the words of § 246 itself connote an

⁶² See Erik Gerding, *United States*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁶³ See U.S. Securities and Exchange Commission, *The Laws that Govern the Securities Industry*, <http://www.sec.gov/about/laws.shtml> (last visited Oct. 10, 2008); see also Krista L. Turnquist, *Pleading Under Section 11 of the Securities Act of 1933*, 98 MICH. L. REV. 2395, 2404-05 (2000).

⁶⁴ See Janine Pascoe, *Malaysia*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁶⁵ See Capital Markets and Services Act, (2007) (Malay.). The preamble to this Act states that it is an "Act to consolidate the Securities Industry Act 1983 [Act 280] and Futures Industry Act 1993 [Act 499], to regulate and to provide for matters relating to the activities, markets and intermediaries in the capital markets, and for matters consequential and incidental thereto."

⁶⁶ See *id.* Part VI, §§ 232-33.

⁶⁷ *Id.* § 236(1). This is defined to be "all such information that investors and their professional advisers would reasonably require, and reasonably expect to find in the prospectus," which is further defined in § 236(2) as information known to a wide list of persons connected to the company. Section 236(3) provides a list of factors relevant to the determination of the appropriate contents of the prospectus.

⁶⁸ *Id.* § 246.

⁶⁹ See *id.* § 248, Part XI, § 357.

⁷⁰ *Id.* § 250.

⁷¹ *Id.* § 251.

⁷² *Id.* § 254.

active participation by “authorising or causing the issue of the prospectus.”⁷³ Some conduct also attracts criminal liability.⁷⁴

In the United Kingdom,⁷⁵ capital raising is governed by the Financial Services and Markets Act 2000. The duty of disclosure requires the prospectus or listing particulars to:

contain all such information as investors and their professional advisors would reasonably require, and reasonably expect to find there, for the purposes of making an informed assessment of—(a) the assets and liabilities, financial position, profits and losses, and the prospects of the issuer of the securities; and (b) the rights attaching to the securities.⁷⁶

The Act provides a compensation remedy to persons who have suffered loss as a result of any untrue or misleading statement in the relevant document or any the omission from the particulars of any matter required to be included.⁷⁷ Defences are available under Schedule 10 of the Act.

In South Korea,⁷⁸ there has been a process of legislative consolidation, and the capital raising provisions are now located in the Capital Market and Financial Investment Act, which was passed in August 2007. This Act provides that where there are false or misleading statements or omissions about material information in prospectuses used to offer securities to the public, directors may be liable to purchasers for damages incurred as a result.⁷⁹ A due diligence defence applies. Directors may also be subject to criminal liabilities for failure of the duty to disclose.⁸⁰

In France,⁸¹ directors can be held liable under civil, criminal and administrative provisions in relation to the issue of securities. The markets are protected by an independent agency, the Autorité des Marchés Financiers

⁷³ *Id.* § 246.

⁷⁴ *See id.* § 243(12).

⁷⁵ J. Lowry, *United Kingdom*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁷⁶ Financial Services and Markets Act, 2000, § 80 (U.K.).

⁷⁷ *Id.* § 90.

⁷⁸ O. Song, *South Korea*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

⁷⁹ [Capital Market and Financial Investment Act] § 125 (S. KOR.).

⁸⁰ *Id.* § 444.

⁸¹ C. Mauro, *France*, in *DIRECTORS' LIABILITY FOR CORPORATE FAULT* (Helen Anderson ed., 2008) (forthcoming 2008).

(“AMF”). While the Code de commerce deals with disclosures for listed companies,⁸² the Code monétaire et financier provides for liability for:

[W]hoever carries out or attempts to carry out, directly or through an intermediary, a manoeuvre intended to impede the normal operation of a regulated market by misleading others [or] . . . publicly disseminates, via whatever channel or means, any false or deceptive information concerning the prospects or the situation of an issuer whose securities are traded on a regulated market, or the likely performance of a financial instrument admitted to trading on a regulated market, which might affect the price thereof.⁸³

In summary, all the jurisdictions surveyed require some form of disclosure document when companies seek to raise funds from the public. All impose liability on directors for false statements and omissions in the documentation, most being strict liability subject to defences and a few requiring fault. The defences also showed marked similarities, including due diligence, reasonable reliance on the advice of experts and lack of consent to the statement. These liability provisions impose a considerable burden on directors to ensure that correct and complete information is provided to prospective investors.

B. Similarities in Unremitted Employee Tax Installment Laws Across Selected Jurisdictions

In many jurisdictions, companies act as tax collectors by retaining from employees' wages an amount representing the employees' taxation obligations with respect to those wages. This is then remitted to the relevant revenue authority and credited to the tax liability of those employees. When money is in short supply, a company can be tempted to treat these tax installments as working capital to finance its operations, rather than remitting them as required. If the company trades out of its financial difficulties, no harm is done. However, if the company becomes insolvent and fails, the loss either falls on the employee or the revenue authority. To deter this behavior, and to provide compensation when it does occur, many jurisdictions have now legislated to impose quite harsh liability on directors for these unremitted tax installments.

⁸² C. COM. art. 242-6-2 (Fr.) imposes criminal liability for directors who give false information relating to the financial position of the company, with the aim of hiding the truth. For the English language version of French legislation, see <http://195.83.177.9/code/index.phtml?lang=uk>.

⁸³ C. MONETAIRE ET FINANCIER art. L465-2 (Fr.).

Australia⁸⁴ has seen some significant increases in the liability for directors for their own actions over the past fifteen years. One of the most noteworthy is the imposition of personal liability for taxation installments which the company has failed to remit. Briefly,⁸⁵ since 1993, Australian company directors have been potentially liable for the unremitted installments of tax which they deduct from workers' salaries, amongst other things, in the event that their company does not pay them in a timely manner.⁸⁶ The Australian Taxation Office ("ATO") gives the directors written notice of a "penalty," equal to the amount of the unremitted tax owed by the company.⁸⁷ The director then has fourteen days to cause the company to comply with its tax obligations or to undertake one of a number of other specified actions,⁸⁸ failing which, the director will become personally liable to pay the amount of the penalty. While a number of defences exist, they are difficult to establish.⁸⁹ In addition, even if the director causes the company to pay the unremitted installments to the ATO in the lead-up to insolvency, the director will be personally liable to the Commissioner of Taxation for the debt if the liquidator successfully claws back this preferential payment from the ATO.⁹⁰

While the introduction of these laws in 1993 caused some concern amongst commentators,⁹¹ Australia is now in line with many other parts of the world. For example, in Canada,⁹² directors may be jointly and severally liable with the corporation for the company's failure to deduct and remit employees' installments of income tax.⁹³ Directors can avail themselves of a

⁸⁴ See Wheelwright, *supra* note 6.

⁸⁵ These provisions are discussed in more detail in other publications. See Stephen Barkoczy & Mei-Ling Barkoczy, *Directors' Liability and the New Regime for Collecting Unremitted Tax Instalments*, 6 REVENUE L. J. 147 (1996); Christopher Symes, *Reminiscing the Taxation Priorities in Insolvency*, [2005] J. OF THE AUSTRALIAN TAX TEACHERS ASS'N 23 (2005); Patricia Blazey, *Non Payment of Pay As You Go Withholding Tax and the Implications for Company Directors*, [2006] J. OF THE AUSTRALASIAN TAX TEACHERS ASS'N 29 (2006); Helen Anderson, *Directors' Liability for Unpaid Employee Entitlements—Suggestions for Reform Based on their Liabilities for Unremitted Taxes*, 30(3) SYDNEY L. REV. 470 (2008).

⁸⁶ Income Tax Assessment Act, 1936, § 222AOB-222AQD (Austl.).

⁸⁷ *Id.* § 222AOE.

⁸⁸ Under Income Tax Assessment Act, 1936, § 222AOB(1) (Austl.), these include entering into a repayment agreement pursuant to § 222ALA, placing the company into administration, or winding the company up.

⁸⁹ See, e.g., *Fitzgerald v. Deputy Commissioner of Taxation* (1995) 95 ATC 4587, 4590 (Austl.). See also Barkoczy, *supra* note 85.

⁹⁰ Corporations Act, 2001, § 588FGA (Austl.). This is subject to a number of defences under § 588FGB.

⁹¹ See sources cited *supra* note 85.

⁹² See Sarra, *supra* note 17.

⁹³ Income Tax Act, R.S.C., ch. 1 § 227.1 (1985) (Can.), as amended: "(1) Where a corporation has failed to deduct or withhold an amount as required . . . has failed to remit such an amount or has failed to pay an amount of tax . . . , the directors of the corporation at the time the corporation was required to

due diligence defence⁹⁴ where they have exercised the degree of care, diligence and skill that a reasonably prudent person would have exercised to prevent the failure in comparable circumstances. Directors' liability ceases two years after directors cease to hold a directorship.⁹⁵

In South Africa, the Income Tax Act 1962 provides for strict liability on the part of directors with respect to unremitted employee tax installments. It provides that “[w]here an employer is a company, every shareholder and director who controls or is regularly involved in the management of the company’s overall financial affairs shall be personally liable for the employees’ tax, additional tax, penalty or interest for which the company is liable.”⁹⁶ There is no director liability for other unpaid taxes, with the exception of value added tax. No defences are available.

In New Zealand,⁹⁷ joint and several liability can be imposed on directors for the income tax of a company. Section HD15(1) of the Income Tax Act 2007 deals with arrangements entered into by companies which prevent them from meeting their tax obligations. For the section to apply the purpose of the arrangement must have been to have this effect, and then only if, had “a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the income tax liability would, or would likely, be required to be met.”⁹⁸ Liability is subject to some exclusions⁹⁹ and defences.¹⁰⁰ Section 141F of the Tax Administration Act of 1994 also states that where any shortfall penalty is imposed on a company and where a director fails to fulfill specified responsibilities under taxation law, he or she may be held liable for a portion of that shortfall penalty.

deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.” Liability is subject under subsection 2 to the corporation’s inability to pay, as evidence by unsatisfied execution of a registered liability, its liquidation or assignment or bankruptcy order.

⁹⁴ Income Tax Act, R.S.C., ch. 1 § 227.1(3) (1985) (Can.) (as amended).

⁹⁵ *Id.* ch. 1 § 227.1(4).

⁹⁶ Income Tax Act of 1962 R.S.A. Sched. IV, s. 16(2C) (S. Afr.).

⁹⁷ See Noonan & Watson, *supra* note 28.

⁹⁸ Income Tax Act 2007, 2005 S.N.Z. No. 97, § HD15(1)(c)(ii) (N.Z.).

⁹⁹ *Id.* § HD 15(2).

¹⁰⁰ *Id.* § HD15(3) provides that: “All persons who are directors of the company at the time the arrangement is entered into are treated as agents of the company in relation to the tax obligation, and the liability is joint and several. But a director has no liability if—(a) they do not derive a benefit from the arrangement, and at the first reasonable opportunity after becoming aware of the arrangement, or the aspects of the arrangement that cause this section to apply to it, they record formally their dissent in relation to the arrangement with the company and with the Commissioner; or (b) they were not at the relevant time involved in the executive management of the company and had no knowledge of the arrangement, or the aspects of the arrangement that cause this section to apply to it.”

Some countries require an element of fault on the part of the director. For example, in the United States,¹⁰¹ § 6672(a) of the Internal Revenue Code 1954 provides that:

[A]ny person required to collect, truthfully account for, and pay over any tax . . . who willfully fails to collect such tax, or truthfully account for and pay over such tax, . . . shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax . . . not accounted for and paid over.¹⁰²

The Internal Revenue Code requires that employers withhold federal income taxes and social security taxes from their employees' wages.¹⁰³ Because the employer holds these taxes as "special fund[s] in trust for the United States",¹⁰⁴ the withheld amounts are commonly referred to as "trust fund taxes."¹⁰⁵ While an employer remains liable for its failure to remit trust fund taxes, the Internal Revenue Code also imposes personal liability, in an amount equal to an employer's deficient taxes, upon those officers or employees responsible for collecting, accounting for, and remitting payroll taxes, who willfully fail to do so.¹⁰⁶

In France, any director, whether formally appointed or de facto, of any corporation, is jointly liable with the corporation for the payment of any tax, if, by fraudulent tactics or serious and repeated violations of tax law, he makes the collection of taxes impossible.¹⁰⁷ Case law has established a number of generous defences.¹⁰⁸ In Malaysia,¹⁰⁹ the Director-General of Inland Revenue may ignore transactions which have the direct or indirect effect of avoiding or evading tax, pursuant to § 140(1) of the Income Tax Act.

By contrast, in South Korea,¹¹⁰ directors are not liable, although interestingly, shareholders who receive a distribution of the company's

¹⁰¹ See Gerding, *supra* note 62.

¹⁰² See *United States v. Sotelo*, 436 U.S. 268 (1978).

¹⁰³ 26 U.S.C. §§ 3402(a), 3102(a) (2006).

¹⁰⁴ 26 U.S.C. § 7501(a) (2006).

¹⁰⁵ *Slodov v. United States*, 436 U.S. 238, 243 (1978).

¹⁰⁶ See 26 U.S.C. § 6672(a) (2006); 26 U.S.C. § 6671(b) (2006); see also *O'Connor v. United States*, 956 F.2d 48, 50 (4th Cir. 1992) (outlining elements of 26 U.S.C. § 6672 (2006) liability).

¹⁰⁷ *Livre des procédures fiscales*, July 26, 2005, art. L 267 (Fr.).

¹⁰⁸ These include that even if formally appointed, the director was not assuming in fact the direction of the corporation; Cass. com., March 3, 2004, RJF 7/04, No. 792; that he had delegated his powers in the tax field to another person; Cass. com., April 25, 2006, BF 8--9/06, Inf. 951; or that the tax was not due at the time he was managing the corporation; *id.*

¹⁰⁹ See Pascoe, *supra* note 64.

¹¹⁰ See Song, *supra* note 78.

residual assets when the company is wound up may be liable as secondary tax debtors for unremitted taxes,¹¹¹ as may the shareholders in family-owned companies.¹¹² Likewise, China's new Enterprise Income Taxation Law¹¹³ passed in 2007 does not impose any liability on directors for unpaid corporate tax debts.

Similarly, in the United Kingdom,¹¹⁴ directors are not liable for unremitted taxes. The only liability which might be imposed in such cases is for misfeasance and disqualification on the grounds of "unfitness" under the Company Directors Disqualification Act 1986.

In summary, some of the jurisdictions surveyed impose liability on directors for unremitted taxation installments. Notably, the similarity, in form or substance, present in laws relation to capital raising, does not exist in unremitted taxation installments. Some countries such as Australia, South Africa, and Canada, impose strict liability, with Australian and Canada allowing defences. Other countries, such as France and the United States, require proof of fault. Some countries have no law at all in this area.

In many countries, in order to protect the revenue base and the operations of government, taxation legislation traditionally is onerous. However, as a corporate stakeholder, the revenue authority is the most highly diversified creditor imaginable, and therefore arguably the least deserving of harsh protection legislation. The non-payment of the debts of one or more failing companies is unlikely to cause significant financial loss. This may explain why some jurisdictions do not impose personal liability on directors for the recovery of these amounts. Nonetheless, liability serves an important deterrent function, which may account for the severity of the provisions in a number of the jurisdictions surveyed.

C. *Similarities in Environmental Protection Laws Across Selected Jurisdictions*

With increasing discussion of global warming, climate change and carbon emissions, and in the wake of some devastating environmental disasters caused by corporate misconduct, it is unsurprising that many countries have widespread environment protection legislation. Unlike the forms of liability discussed above, the harm caused by breach of environment protection laws is not necessarily redressable purely by money

¹¹¹ [National Tax Collection Act] art. 34 (S. KOR.).

¹¹² [Corporate Tax Code] art. 2, Item 10 (S. KOR.).

¹¹³ Enterprise Income Taxation Law (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 16, 2007, effective Jan. 1, 2008) (P.R.C.).

¹¹⁴ See Lowry, *supra* note 75.

and often is not limited to a small class of plaintiffs. Perhaps in recognition that deterrence is more important than compensation, the laws examined below tend to impose criminal, rather than civil, liability on directors.

In Australia,¹¹⁵ there is extensive environmental protection legislation.¹¹⁶ Some acts impose liability on directors for the faults and defaults of their companies. Directors may face criminal prosecutions under state legislation.¹¹⁷ The “positional/managerial” liability model is the most common,¹¹⁸ where persons holding certain positions within a company are liable for the company’s breach of the law. Other models of liability include positional, managerial, responsible officer, participatory and accessorial.¹¹⁹ Defences are available under the statutes.¹²⁰ They differ markedly depending on the particular piece of legislation, although most commonly include due diligence and the lack of ability of the individual to influence the contravention because of the position he or she holds.

Canada¹²¹ is also typified by a multitude of statutes governing environmental protection, with more than thirty statutes imposing liability on directors for breach. Personal liability is generally imposed on those persons who have charge, management or control of the corporation’s activities or property, which occurs if they take an active role in the business or if they had a duty or opportunity to take preventive or corrective action but failed to do so.¹²² Directors who authorise, permit, or acquiesce in their corporation’s offence will be liable for the same offence pursuant to many environmental statutes in Canada.¹²³ The applicable penalties are fines, with imprisonment reserved for serious misconduct.¹²⁴ Liability is strict, with a

¹¹⁵ See Wheelwright, *supra* note 6.

¹¹⁶ Examples of federal legislation include Protection of the Sea (Civil Liability) Act, 1981 (Austl.); Protection of the Sea (Prevention of Pollution from Ships) Act, 1983 (Austl.); Environment and Heritage Legislation Amendment Act (No. 1), 2003 (Austl.); World Heritage Properties Conservation Act, 1983 (Austl.); Environment Protection (Sea Dumping) Act, 1981 (Austl.); Environment Protection and Biodiversity Conservation Act, 1999 (Austl.); Hazardous Waste (Regulation of Exports and Imports) Act, 1989 (Austl.).

¹¹⁷ These are set out in Appendix 6 of the Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault Discussion Paper*, May 2005, available at [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/\\$file/Personal_Liability_DP_May05.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/Personal_Liability_DP_May05.pdf).

¹¹⁸ *Id.* at 33.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ See Sarra, *supra* note 17.

¹²² See J. Sarra & R. Davis, *Director and Officer Liability*, in *CORPORATE INSOLVENCY* (Butterworths 2002).

¹²³ See *e.g.*, Environmental Protection Act, R.S.C., c. 33 (1999) (Can.).

¹²⁴ Examples of statutes that include imprisonment as a potential sanction include the Environmental Protection Act R.S.C. (1999) (Can.); the Ontario Environmental Protection Act, R.S.O. c. E-19 (1990) (Can.); the Alberta Environmental Protection and Enhancement Act, R.S.A., c. E-12 (2000) (Can.); and the British Columbia Water Act, R.S.B.C. c. 483 (1996) (Can.).

due diligence defence.¹²⁵ This includes a requirement to establish proper and effective preventative and reporting systems.¹²⁶ Former directors may also be liable, acknowledging the fact that environmental damage may take some time to become evident.¹²⁷

China¹²⁸ has in recent years increased its regulation of the environment¹²⁹ and has embraced international cooperation in environmental protection.¹³⁰ However, there have been a number of impediments to actual protection of the environment, including the growth of China's industry, gaps in the legislation and lack of enforcement. While there is a central body¹³¹ responsible for environmental protection, local enforcement remains with local governments. While the persons directly responsible for a serious environmental pollution accident are subject to administrative sanction,¹³² the law does not provide for the joint liability of directors in civil actions to pay compensation to parties affected. However, China's Criminal Law imposes criminal sanctions including fines and imprisonment¹³³ on persons directly responsible for violations of environmental law regarding pollution and waste control,¹³⁴ forestry law,¹³⁵ and mineral resources law.¹³⁶

In South Africa,¹³⁷ the National Environmental Management Act 1998 imposes criminal and civil liability on directors in an unusual way. Section 34(1) provides that:

Whenever any person is convicted of an offence under any provision listed in Schedule 3 and it appears that such person has by that offence caused loss or damage to any organ of state or other person, including the cost incurred or likely to be incurred by an organ of state in rehabilitating the environment

¹²⁵ R. v. Bata Industries Ltd., [1992] O.J. No. 236 (Can.) (Ont.).

¹²⁶ *Id.*

¹²⁷ See e.g., Environmental Management Act, S.B.C., c. 53, § 47(1) (2003).

¹²⁸ See Chenxia Shi & Hu Bin, *supra* note 38.

¹²⁹ The National People's Congress has since 1949 passed 9 laws on environmental protection and 15 laws on the protection of natural resources. See Environmental Protection in China (1996-2005), a white paper released by the State Council in June 2006, available at <http://www.china.org.cn/english/MATERIAL/170257.htm>.

¹³⁰ China has acceded to more than 50 international conventions on environmental protection. See *id.*

¹³¹ The State Environmental Protection Administration ("SEPA").

¹³² Environmental Protection Law (1989) art. 38 (promulgated by Order No. 22 of the President of the P.R.C., Dec. 26, 1989, effective on the date of promulgation) (P.R.C.).

¹³³ Criminal Law (1999) arts. 338-346 (promulgated by Order No. 83 of the President of the P.R.C., Mar. 14, 1997, adopted by the Second Session of the Fifth Nat'l People's Cong., Jul. 1, 1979, amended at the Fifth Session of the Eighth Nat'l People's Cong., Mar. 14, 1997) (P.R.C.)

¹³⁴ *Id.* arts. 338 and 339.

¹³⁵ *Id.* art. 344.

¹³⁶ *Id.* art. 343.

¹³⁷ Van der Linde, *supra* note 46.

or preventing damage to the environment, the court may . . . inquire summarily and without pleadings into the amount of the loss or damage so caused.

Directors are named in subsection 8 as parties who may be so convicted. Subsection 7 states that directors are guilty “if the offence in question resulted from the failure of the director to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence”; the burden of disproving this lies with the director.¹³⁸

In the United Kingdom,¹³⁹ protection of the environment is governed mainly by the Environmental Protection Act 1990.¹⁴⁰ The HM Inspectorate of Pollution or the local authority Environmental Health Officer may take action against directors, as well as the company, for breaches of the law.¹⁴¹ Criminal penalties include both fines and imprisonment, as well as disqualification from acting as a director.¹⁴²

In Hong Kong,¹⁴³ there are a range of ordinances imposing criminal liability for damage to the environment, or failure to protect the natural and cultural environment.¹⁴⁴ In addition, future impact on the environment is

¹³⁸ National Environmental Management Act of 1998 s. 34(7) (S. Afr.) concludes with the words: “Provided that proof of the said offence by the firm shall constitute prima facie evidence that the director is guilty under this subsection.”

¹³⁹ Lowry, *supra* note 75.

¹⁴⁰ See also Environment Act, 1995, c. 25 (U.K.), The Control of Substances Hazardous to Health Regulations, 1999, S.I. 1999/437 (U.K.), and The Control of Major Accident Hazards Regulations, 1999, S.I. 1999/743 (U.K.).

¹⁴¹ This may be done pursuant to the United Kingdom Environmental Protection Act, 1990, c. 43, § 157(1), which provides that: “Where an offence under any provision of this Act committed by a body corporate is proved to have been committed with the consent or connivance of, or to have been attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the body corporate or a person who was purporting to act in any such capacity, he as well as the body corporate shall be guilty of that offence and shall be liable to be proceeded against and punished accordingly.”

¹⁴² The Company Directors Disqualification Act, 1986, c. 46, § 2 (U.K.) provides that the court may, in its discretion, issue a “disqualification order against a person convicted of an indictable offence (whether on indictment or summarily) in connection with the promotion, formation, management liquidation or striking off of a company with the receivership of a company’s property or with his being an administrative receiver of a company.” The offence does not have to relate to the actual management of the company provided it was committed in “connection” with its management.

¹⁴³ Goo et al., *supra* note 54.

¹⁴⁴ For damage to the environment, see the Air Pollution Control Ordinance, (1983, as amended 1991) Cap. 311. (H.K.); Water Pollution Control Ordinance, (1981) Cap. 358. (H.K.); Dumping at Sea Ordinance, (1995) Cap. 466. (H.K.); and Merchant Shipping (Prevention and Control of Pollution) Ordinance, (1991) Cap. 413. (H.K.). For the specific problem of oil pollution, see Merchant Shipping (Liability and Compensation for Oil Pollution) Ordinance, (1991) Cap. 414. (H.K.); Noise Control Ordinance, (1989, as amended 1992 and 1996) Cap. 400. (H.K.); Civil Aviation (Aircraft Noise) Ordinance, (1986) Cap. 312. (H.K.); and Waste Disposal Ordinance, (1980, as amended 1985, 1989, and 1992) Cap. 354. (H.K.). For failure to protect the natural environment, see Animals and Plants (Protection of Endangered Species) Ordinance, (1976, as amended 2006) Cap. 187. (H.K.); Marine Fish Culture Ordinance, (1980, as amended 1982) Cap. 353. (H.K.); Wild Animals Protection Ordinance, (1976) Cap.

governed by the Environmental Impact Assessment Ordinance,¹⁴⁵ where developers must indicate the likely impact of their plans upon the environment. The criminal liability of certain persons, including directors of companies, is provided for under § 29(1).¹⁴⁶

Malaysia¹⁴⁷ also has environmental laws, such as the Environmental Quality Act 1974, which impose criminal liability upon directors for breaches committed by their companies. Section 43(1) of the Act deems directors to be liable for the environmental offences of their company unless one of the defences contained in that subsection applies.¹⁴⁸

In South Korea,¹⁴⁹ environmental protection is now heavily regulated.¹⁵⁰ Companies may be criminally liable for breaches.¹⁵¹ While there are no provisions imposing civil liability on companies, directors may be liable for the amount of any criminal penalty imposed on their company if that penalty is attributable to a breach of the directors' fiduciary duty, dependent on proof of negligence or intent to commit the violation. Directors are not liable in the absence of personal fault, even where the relevant statute imposes strict liability on the company.¹⁵²

The United States¹⁵³ has the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA").¹⁵⁴ This federal statute,

170. (H.K.); Whaling Industry (Regulation) Ordinance, (1996) Cap. 496. (H.K.); and Forests and Countryside Ordinance, (1937, as amended 1974) Cap. 96. (H.K.). For failure to protect the cultural environment, see Antiquities and Monuments Ordinance, (1976) Cap. 53. (H.K.). All of the previous are available at Hong Kong Ordinances, <http://www.hklii.hk/hk/legis/ord/>.

¹⁴⁵ Environmental Impact Assessment Ordinance, (1998) Cap. 499. (H.K.).

¹⁴⁶ Hong Kong Environmental Impact Assessment Ordinance, (1998) Cap. 499, § 29(1) provides that: "Where a person convicted of an offence under this Ordinance is a body corporate and it is proved that the offence was committed with the consent or connivance of, or was attributable to any neglect or omission on the part of, a director, manager, secretary or other person concerned in the management of the body corporate, the director, manager, secretary or other person also commits the offence."

¹⁴⁷ Pascoe, *supra* note 64.

¹⁴⁸ Environmental Quality Act, (1974) § 43(1) (Malay.). These include lack of knowledge and consent, and that the directors exercised due diligence to prevent the commission of the offence.

¹⁴⁹ Song, *supra* note 78.

¹⁵⁰ More than 20 laws regulate environmental issues, in areas such as noise, air, soil, water, sewage, and the preservation of nature. *See, e.g.*, [Framework Act on Environmental Policy, Law No. 4257] (1990) (S. KOR.) (last revised by Law No. 8471 of 2007); [Clean Air Conservation Act, Law No. 4262] (1990) (S. KOR.) (last revised by Law No. 7779 of 2005); [Water Quality Conservation Act, Law No. 7459] (2005) (S. KOR.); [Natural Environment Conservation Act, Law No. 7297] (2004) (S. KOR.) (last revised by Law No. 8468 of 2007); [Soil Environment Conservation Act, Law No. 4906] (1995) (S. KOR.) (last revised by Law No. 7459 of 2005). For a short history of the development of South Korean environmental law, see Hong Sik Cho, *An Overview of Korean Environmental Law*, 29 ENVTL. L. 501 (1964).

¹⁵¹ For instance, [Act on Fundamentals on Environmental Policy] art. 31 (S. KOR.) provides that an enterprise must pay damages if the pollution is caused by the enterprise. *See also* [Act on Preservation of Soil Environment] art. 10-3(1) (S. KOR.).

¹⁵² [Commercial Code] § 399(1) (S. KOR.).

¹⁵³ Gerding, *supra* note 62.

passed in 1980 following a major environmental disaster,¹⁵⁵ imposes extensive and complicated liability on directors in relation to land contaminated with hazardous waste. Liability attaches to owners and operators, including individual persons, of sites from where such material is released into the environment.¹⁵⁶ However, courts have taken different approaches to the definition of “operators.” The most common approach has been to hold directors liable as “operators” for violations in which they directly participate.¹⁵⁷ While some courts have held directors liable for contraventions of the law where they had the “capacity to control” those operations, even if they did not know of, or directly participate in, those contraventions,¹⁵⁸ Moore notes that “[a] clear majority of courts that have considered the issue claim to adhere to a test for “actual control.”¹⁵⁹

In France,¹⁶⁰ directors may be criminally liable under the Code de l’environnement for a range of crimes.¹⁶¹ These include lesser strict liability offences, as well as more serious crimes under the Code de l’environnement which require negligence or intent. An example of the latter is water pollution.¹⁶²

In summary, while many countries have adopted environmental protection laws, the format of the laws differs, most notably in South Africa and South Korea. Some countries, such as Australia and Canada, impose both criminal and civil liability based on the position held, but subject to defences. Others confine their reach to criminal liability, with a range of fault requirements.

¹⁵⁴ 42 U.S.C. §§ 9601-9675 (2008).

¹⁵⁵ The Love Canal disaster. See also MICHAEL BROWN, *LAYING WASTE: THE POISONING OF AMERICA BY TOXIC CHEMICALS* (Pantheon Books 1979).

¹⁵⁶ 42 U.S.C. § 9607(a)(1)-(3) (2008).

¹⁵⁷ Bryan Moore, *The Corporate Officer as CERCLA Operator: Applying the Holding in United States v. Bestfoods to the Determination of Officer Liability*, 12 TUL. ENVTL. L.J. 519, 526-28 (1999). For further discussion of CERCLA’s interaction with corporate law principles, see Lynda J. Oswald & Cindy A. Schipani, *CERCLA and the “Erosion” of Traditional Corporate Law Doctrine*, 86 NW. U. L. REV. 259 (1992); Cindy A. Schipani, *Integrating Corporate Law Principles with CERCLA Liability for Environmental Hazards*, 18 DEL. J. CORP. L. 1, 5 (1993); Gerding, *supra* note 62.

¹⁵⁸ This is also known as the “authority to control” test. See Moore, *supra* note 157, at 533-40. He distinguishes cases in which courts based director and officer liability determination on whether the individual had “actual control” over hazardous substances from those that used an “authority to control” test. *Id.* 529-40.

¹⁵⁹ *Id.* at 529.

¹⁶⁰ Mauro, *supra* note 81.

¹⁶¹ See, e.g., C. ENVIRONNEMENT arts. L218-20, L218-22, and L218-50.

¹⁶² Law No. 2000-916 of September 19, 2000, Journal Officiel de la République Française [J.O.] [Official Gazette of France], September 22, 2000.

D. Conclusion on Similarities of Laws in Selected Jurisdictions

The discussion above highlights similarities in legislation relating to capital raising, unremitted tax installments, and protection of the environment, across a range of selected jurisdictions. There is a general obligation on companies to produce disclosure documentation in relation to capital offerings to the public, and directors are liable for errors in, and omissions from, such documents. Defences are usually available, but are generally limited to due diligence, reliance on the advice of an expert, or lack of consent to the issuing of the prospectus. Nonetheless, there are some local variations to both the format of the personal and criminal liability provisions and the defences available. This illustrates the point that there are multiple ways for laws to be drafted to meet a common legislative objective.

This pattern continues for unremitted taxes. Most, but not all, of the countries surveyed have laws making directors liable for the unremitted tax installments taken from employees' wages. Again, there are defences. However, some jurisdictions require some element of intent on the part of the directors, making such laws somewhat harder to make out than those relating to capital raising. The diversity between countries is more pronounced, and some countries such as the United Kingdom do not legislate on this matter at all.

In relation to the protection of the environment, most of the countries surveyed impose criminal liability on directors for their companies' actions; however, not all impose civil liability, and the mechanism for finding directors liable differs between strict liability based on position but subject to defences and liability based on actual involvement or fault.

III. DIVERSITY IN DIRECTORS' LIABILITY LAWS BETWEEN JURISDICTIONS

This Part examines three areas in which there are marked differences in the law: insolvent trading, protection of employee entitlements, and compensation of tort claimants. These three areas involve laws for the protection of vulnerable corporate stakeholders. Two observations can be made about laws in the jurisdictions surveyed: the first is that they generally do not provide adequate protection of these stakeholder cohorts, and the second is that the inadequacy of this protection is exhibited in different ways across the jurisdictions. This is in stark contrast to, for example, the protection of prospective investors, where the law is both stringent and noticeably similar across jurisdictions.

A. Diversity in Insolvent Trading Laws in Selected Jurisdictions

Creditors such as banks are largely insulated from corporate failure by holding security over company assets. However, the priority held by secured creditors significantly impacts upon the ability of unsecured creditors to recover when a company becomes insolvent. Unsecured claimants must take their chances of receiving a small payment after the satisfaction of the claims of preferred creditors.¹⁶³

The risk of non-payment is one of the consequences of dealing with a limited liability entity and is generally known and understood by unsecured creditors. Whether this risk can be adequately compensated *ex ante* is the subject of much law and economics literature. Compensation mechanisms include the ability to diversify away the risk of loss by investing in multiple companies, and to charge a premium on the price of goods, services or credit supplied, sufficient to cover the risk of loss. Because small trade creditors in many instances lack the ability to self-protect by these mechanisms, they are vulnerable to the risk of non-payment in the event of their debtor's insolvency. Their loss can have flow-on effects for their own employees and creditors.

Understandably, there is no legislation that allows for the recovery from directors or shareholders of unpaid debts incurred whilst the company is solvent. This undermines the concept of limited liability and the separate legal entity of the company. However, one might expect that the vulnerability of unsecured creditors would justify widespread legislative intervention where the company incurred the debts when it was insolvent. This is not the case. The survey of the jurisdictions outlined below shows that some have laws which are difficult to enforce and others have no legislation on this matter at all.

In Australia,¹⁶⁴ the Corporations Act 2001 imposes both personal liability, and in some cases, criminal penalties, on directors who allow their company to trade whilst insolvent.¹⁶⁵ Section 588G(1) imposes liability on directors for the company's debt, where:

- (a) a person is a director of a company at the time when the company incurs a debt; and

¹⁶³ These typically include the costs of the liquidation and the payment of employees' entitlements.

¹⁶⁴ Wheelwright, *supra* note 6.

¹⁶⁵ This is in addition to directors' duties to the company under the Corporations Act, 2001, c. 2D, pt. 2D.1 (Austl.).

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be . . .

. . . .

(2) By failing to prevent the company from incurring the debt, the person contravenes this section if:

(a) the person is aware at that time that there are such grounds for so suspecting; or

(b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

In addition to being civilly liable, the director commits a criminal offence if the director's failure to prevent the company incurring the debt is dishonest.¹⁶⁶ Courts have a range of options in relation to contraventions of § 588G. In addition to holding the directors liable for the debts of the company from the commencement of insolvent trading, they may impose on directors pecuniary penalties,¹⁶⁷ banning orders,¹⁶⁸ and compensation orders.¹⁶⁹ Defences are available under § 588H.

However, several aspects of the legislation have created problems.¹⁷⁰ The liquidation requirement means that directors can escape liability by placing the company into voluntary administration. If the liquidator chooses not to take action to enforce the provision, creditors face a number of procedural hurdles before they themselves can sue.¹⁷¹

¹⁶⁶ Corporations Act, 2001, c. 5, pt. 5.7B, § 588G(3) (Austl.).

¹⁶⁷ Corporations Act, 2001, c. 9, Pt. 9.4B, § 1317G (Austl.).

¹⁶⁸ Corporations Act, 2001, c. 2D, Pt. 2D.6, § 206B (Austl.) (banning orders disqualify a person from managing a corporation in specified circumstances).

¹⁶⁹ Corporations Act, 2001, §§ 588J, 1317H (Austl.). An order may be sought by the regulator, or by the company's liquidator. Note that the compensation is payable to the company and not to individual creditors.

¹⁷⁰ An example is the definition of insolvency, and whether the commercial reality of a company being able to borrow more money affects its solvency. *See, e.g.,* Powell v. Fryer [2000] S.A.S.C. 97; Southern Cross Interiors Party Ltd. (In Liq) v. Deputy Comm'r of Taxation [2001] 165 F.L.R. 430; Lewis v. Doran [2004] 184 F.L.R. 454. *Cf.* Emanuel Management Party Ltd. v. Fosters Brewing Group Ltd. [2003] 178 F.L.R. 1. *See also* HELEN ANDERSON, CORPORATE DIRECTORS' LIABILITY TO CREDITORS 148-152 (Lawbook Co. 2006).

¹⁷¹ Corporations Act, 2001, c. 5, Pt. 5.7B, §§ 588R-U (Austl.).

The United Kingdom¹⁷² does not have insolvent trading as such. Its legislation affords a dual approach, targeting both fraudulent trading as well as wrongful trading. The former is imposed by § 213 of the Insolvency Act,¹⁷³ which provides that:

(1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.

(2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.

Fraud for the purposes of § 213 has been defined as requiring “actual dishonesty involving, according to current notions of fair trading among commercial men at the present day, real moral blame.”¹⁷⁴ In *Re William C Leitch Brothers Ltd.*,¹⁷⁵ Maugham J. stipulated that this occurs “when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts.”¹⁷⁶ This includes turning a blind eye, where there is a suspicion of the relevant facts together with a deliberate decision to avoid confirming their existence.¹⁷⁷ Criminal liability also applies.¹⁷⁸ The difficulties in making out the requirements of “actual dishonesty” and “real moral blame” led to the enactment of the wrongful trading provisions, following recommendations by the Jenkins Committee¹⁷⁹ and the Cork Committee.¹⁸⁰

Wrongful trading, which is governed by § 214 of the Insolvency Act 1986, is considerably more involved than fraudulent trading. There is the

¹⁷² Lowry, *supra* note 75.

¹⁷³ Insolvency Act, 1986, § 213 (U.K.).

¹⁷⁴ In *Re Patrick and Lyon Ltd.*, [1933] Ch. 786, 790.

¹⁷⁵ In *Re William C. Leitch Brothers, Ltd.*, [1932] 2 Ch. 71. *Cf. Re Augustus Barnett & Son Ltd.*, [1986] B.C.C. 98904.

¹⁷⁶ *Id.* at 77. *See also Welham v. Director of Public Prosecutions*, [1961] A.C. 103; *Bernasconi v. Nicholas Bennett & Co.*, [2000] B.C.C. 921; *Aktieselskabet Dansk Skibsfinansiering v. Brother*, [2000] 1 H.K.L.R.D. 568; *Regina v. Grantham*, [1984] Q.B. 675.

¹⁷⁷ *Morris v. State Bank of India*, [2005] 2 B.C.L.C. 328.

¹⁷⁸ Companies Act, 2006, c. 46, § 993 (U.K.).

¹⁷⁹ BOARD OF TRADE, REPORT OF THE COMPANY LAW COMMITTEE, 1962, Cmnd. 1749, 195 (U.K.).

¹⁸⁰ BOARD OF TRADE, REPORT OF THE REVIEW COMMITTEE INSOLVENCY LAW AND PRACTICE, 1981, Cmnd. 8558, c. 44 (U.K.).

same requirement that the company be wound up in insolvent liquidation, and a person who was a director at that time “is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.”¹⁸¹ Directors may not escape liability by being a “sleeping” director,¹⁸² or through ignorance, either of the facts of the company's insolvency, or of the basic¹⁸³ financial and accounting knowledge necessary to fulfill their obligations.¹⁸⁴

But unlike fraudulent trading, the wrongful trading section requires that the director “knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation,”¹⁸⁵ unless the court is satisfied that the director “took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.”¹⁸⁶ The relevant standard is of a “reasonably diligent person having both—(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the general knowledge, skill and experience that that director has.”¹⁸⁷

Malaysia,¹⁸⁸ like the United Kingdom, imposes liability for both wrongful and fraudulent trading. Breach of the wrongful trading provision, § 303(3) of the Companies Act 1965, is both a civil wrong and a crime attracting serious fines and possible imprisonment.¹⁸⁹ It states:

If in the course of the winding up of a company or in any proceedings against a company it appears that an officer of the company who was knowingly a party to the contracting of a debt had, at the time the debt was contracted, no reasonable or probable ground of expectation, after taking into consideration the other liabilities, if any, of the company at the time, of the company being able to pay the debt, the officer shall be guilty of an offence against this Act.

¹⁸¹ Insolvency Act, 1986, § 214 (U.K.).

¹⁸² *Re Brian D Pierson (Contractors) Ltd.*, [2001] 1 B.C.L.C. 275, 309.

¹⁸³ Insolvency Act, 1986, § 214 (U.K.).

¹⁸⁴ *Re DKG Contractors Ltd.*, [1990] B.C.C. 903, 912.

¹⁸⁵ Insolvency Act, 1986, § 214(2)(b) (U.K.).

¹⁸⁶ *Id.* § 214(3).

¹⁸⁷ *Id.* § 214.

¹⁸⁸ Pascoe, *supra* note 64.

¹⁸⁹ Companies Act, § 303(3) (1965) (Malay.). Breach attracts a penalty of imprisonment for one year or a fine of 5,000 Ringgit.

Section 304(2) provides for directors' liability, stating that:

Where a person has been convicted of an offence under subsection 303(3) in relation to the contracting of such a debt . . . the Court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that the person shall be personally responsible without any limitation of liability for the payment of the whole or any part of that debt.

Possible recovery under the section is limited. The applicant needs to prove that the director knowingly participated in the incurrance of the debt and that the director had no reasonable or probable ground to expect that the company could pay it.¹⁹⁰ In addition, by making criminal liability a prerequisite for civil liability, the criminal burden of proof is imposed onto the recovery by the liquidator or creditor. There are also criminal sanctions for those who "knowingly" carry on the business of the company with the intent to defraud creditors.¹⁹¹ Here, civil recovery is not linked to a criminal conviction, but the requirement to prove an intent to defraud is a significant hurdle.¹⁹²

Like the United Kingdom, Hong Kong¹⁹³ allows for directors' liability for fraudulent trading, but it has not adopted the more recent wrongful trading provisions of its former colonial governors. Section 275(1) of the Companies Ordinance¹⁹⁴ provides that:

If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court, on the application of the Official Receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct.

¹⁹⁰ *Id.*

¹⁹¹ *Id.* §§ 304(1), 304(5).

¹⁹² There is one reported case: *H. Rosen Engineering B.V. v. Siow Yoon Keong* [1997] 1 C.L.J. 137, 1 A.M.R. 157 (Malay.).

¹⁹³ Goo et al., *supra* note 54.

¹⁹⁴ Companies Ordinance, (1997) Cap. 32, § 275(1) (H.K.), available at <http://www.hkllii.org/hk/legis/ord/32/s275.html>.

The British definition of fraud applies in Hong Kong, so that directors are liable if there is proof that they knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation.¹⁹⁵ This is a question of fact resolved by asking whether the director's decision to continue to trade involved unnecessary risks to the repayment of creditors.¹⁹⁶ Section 275(3) of the Companies Ordinance imposes criminal liability.

New Zealand¹⁹⁷ also has laws against fraudulent trading.¹⁹⁸ Liability is provided for in § 380(2) of the Companies Act.¹⁹⁹ Due to the purpose requirement in this section, it is not targeted at directors whose only motivation is to save the company, regardless of whether that aim was unrealistic.²⁰⁰ Section 135 deals with reckless trading,²⁰¹ imposing a duty, objectively assessed, on directors to supervise the company's business.²⁰² Section 136 imposes an overlapping duty, providing that: "[a] director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so."

South Africa²⁰³ takes a different approach, by including both fraudulent and reckless trading in one section. Section 424 of the Companies Act 1973 imposes personal liability on directors, by providing that:

¹⁹⁵ In *Re William C. Leitch Ltd.*, [1932] 2 Ch. 71, *see also supra* note 175 and accompanying text.

¹⁹⁶ *See, e.g.*, *Sec'y of State for Trade and Indus. v. Gash*, [1997] 1 B.C.L.C. 341; *Re Amaron Ltd.*, [1998] B.C.C. 264; *Re Park House Properties Ltd.*, [1998] B.C.C. 847; *Re McNulty's Interchange Ltd. & Anor.*, [1988] 4 B.C.C. 533; *Sec'y of State for Trade and Indus. v. Joiner Re Synthetic Tech. Ltd.*, [1993] B.C.C. 549.

¹⁹⁷ Noonan & Watson, *supra* note 28.

¹⁹⁸ Companies Act 1993, 1993 S.N.Z. No. 105, § 380(1) (N.Z.) makes it an offence for directors to carry on business with an intent to defraud creditors or any other person or for a fraudulent purpose. In addition, § 33 of the Companies Amendment Act 2006, 2006 S.N.Z. No. 56 (N.Z.) makes it an offence for directors who, with intent to defraud a creditor or creditors, do anything that causes material loss to any creditor.

¹⁹⁹ Companies Act 1993, 1993 S.N.Z. 105 § 380(2) (N.Z.): "Every director of a company who,—(a) By false pretences or other fraud induces a person to give credit to the company; or (b) With intent to defraud creditors of the company,—(i) Gives, transfers, or causes a charge to be given on, property of the company to any person; or (ii) Causes property to be given or transferred to any person; or (iii) Caused or was a party to execution being levied against property of the company—commits an offence and is liable on conviction to the penalties set out in § 373(4) of this Act."

²⁰⁰ *See Re Nimbus Trawling Co. Ltd.*, [1986] 2 N.Z.L.R. (C.A.) (N.Z.); *Keegan v. Page Vivian Motors Ltd.*, [1986] 2 N.Z.L.R. 308 (C.A.) (N.Z.).

²⁰¹ "A director of a company must not—(a) Agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or (b) Cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors."

²⁰² *See Mason v. Lewis*, [2006] 3 N.Z.L.R. 225 (C.A.) (N.Z.).

²⁰³ Van der Linde, *supra* note 46.

When it appears, . . . that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.²⁰⁴

Intent is a key issue. In order to qualify as *reckless* the business must be carried on with a minimum of gross negligence, while the minimum requirement for fraudulent trading is intent in the form of *dolus eventualis*.²⁰⁵ Trading whilst insolvent is not sufficient on its own to constitute recklessness or fraud; nonetheless, where a company continues to incur debts when a reasonable person in business would have realized that there was no reasonable prospect that the creditors would receive payment when due, courts will draw an inference of recklessness.²⁰⁶ The director can be held liable for “all or any” of the debts of the company,²⁰⁷ and there is no need to prove a causal connection between the reckless or fraudulent carrying on of the business and the debt or debts for which liability is sought to be imposed.²⁰⁸ Criminal liability may also be imposed.²⁰⁹

In France,²¹⁰ the Code de commerce contains arguably very harsh provisions on directors in the event of a company’s insolvency. Article L 651-2 of the Code de commerce imposes liability for any director,

²⁰⁴ Companies Act of 1973 s. 424 (S. Afr.), available at <http://www.acts.co.za/company/index.htm>.

²⁰⁵ *Dolus eventualis* (indirect intention) exists when the possibility of a particular consequence or circumstance is foreseen, and there is a reckless disregard as to whether it ensues or not. The person knows that the action—or the consequences of the action—are wrong. See C. G. VAN DER MERWE & J. E. DU PLESSIS, INTRODUCTION TO THE LAW OF SOUTH AFRICA 304 (Kluwer Law Int’l. 2004).

²⁰⁶ See *Ozinsky NO v Lloyd and Others* 1995 (2) SA 915 (A) (S. Afr.); *Philotex (Pty) Ltd. v Snyman, Braitex (Pty) Ltd. v Snyman* 1998 (2) SA 138 (SCA) (S. Afr.); *Terblanche NO v Damji* 2003 (5) SA 489 (C) (S. Afr.).

²⁰⁷ Companies Act of 1973 s. 424(1) (S. Afr.).

²⁰⁸ According to *Saincic v Industro-Clean (Pty) Ltd.* 2006 SCA 77JOL 17559 (SCA) (S. Afr.), the Supreme Court of Appeal of South Africa “held in *Philotex (Pty) Ltd. v. Snyman, Braitex (Pty) Ltd. v. Snyman*, 1998 (2) SA 138 (SCA) at 142 H-I, that it is not necessary to prove a causal link between the relevant conduct and the debts or liabilities for which there is a declaration of personal liability in terms of s. 424. But the absence of such a proven link is a factor to be taken into consideration by the court in the exercise of its discretion and in order to decide whether such a declaration is, in all the circumstances, just and equitable.” *Philotex* was distinguished on the facts in *Saincic*.

²⁰⁹ Companies Act of 1973 s. 424(3) (S. Afr.).

²¹⁰ See Mauro, *supra* note 81.

amongst others, where the insolvency of the company is partly or entirely due to a director's fault in management. It provides:

Where the rescission of a safeguard or of a reorganization plan or the liquidation of a legal entity reveals an excess of liabilities over assets, the court may, in instances where management fault has contributed to the excess of liabilities over assets, decide that the debts of the legal entity will be borne, in whole or in part, by all or some of the de jure or de facto managers, who have contributed to the management fault. If there are several managers, the court may, by way of a reasoned ruling, declare them jointly and severally liable. The right of action shall be barred after three years from the date of issuance of the order pronouncing the liquidation proceedings or the rescission of the plan. Sums paid by the managers in compliance with the first paragraph shall form part of the debtor's assets. These sums shall be distributed to all creditors on a pro rata basis.²¹¹

In addition, Article L 653-2 of the Code de commerce allows the court to disqualify the director from holding that office in any other company for a maximum of fifteen years.²¹² Further criminal liability is found in Article L 654-2 Code de commerce where the director commits certain crimes during the company's bankruptcy.²¹³ These include embezzlement, concealing the company's property or increasing the insolvency of the company. If these same acts take place before the insolvency starts, they constitute a misuse of company assets and the director is liable for breach of his fiduciary duties.²¹⁴

In China,²¹⁵ there is no insolvent trading liability as such. However, there are a number of provisions relating to insolvency that act to protect creditors. China's Enterprise Bankruptcy Law,²¹⁶ which came into effect on June 1, 2007, lifts the corporate veil, imposing liability on directors of insolvent companies where breaches of fiduciary duties cause the

²¹¹ C. COM. art. L 651-2.

²¹² C. COM. art. L 653-2, 11.

²¹³ C. COM. art. L 654-2, 3. The law establishes a maximum term of 5 years imprisonment and 75,000 euro fine.

²¹⁴ C. COM art. L 242-6 § 3.

²¹⁵ See Chenxia Shi & Hu Bin, *supra* note 38.

²¹⁶ The Enterprise Bankruptcy Law (promulgated by Presidential Order No. 54, Aug. 27, 2006, effective June 1, 2007) (P.R.C.) replaced the State Enterprise Bankruptcy Law (Trial Implementation) (1986). See generally Chau E. Jin & Clifford C. Shanghai, *The Reform of PRC Corporate Bankruptcy Law: Slowly but Surely*, 16(8) CHINA L. & PRAC. 19 (2002).

liquidation.²¹⁷ Disqualification orders may also be sought against directors, and the company's administrator can claw back assets which were diverted to avoid the reach of creditors.²¹⁸ Similarly, the administrator may recover assets embezzled by directors and managers, and these directors may be ordered to pay compensation to creditors whose interests have been harmed.²¹⁹ In addition, a range of criminal penalties apply.²²⁰

As in China, there is no specific liability for insolvent trading in South Korea.²²¹ Liability to a third party is only imposed on a director where loss is incurred as a result of the director's neglect of his or her duties to the company, if such neglect results from wrongful intent or gross negligence.²²² This includes the behavior of directors during periods of financial difficulty, if such behavior interferes with the company's ability to pay its debts.

In summary, a superficial examination of the provisions outlined above might give the impression that there is extensive civil and criminal legislation governing insolvent trading. However, the requirements of proof of knowledge and, in some cases, intent, the availability of defences, and a variety of procedural hurdles significantly affect the effectiveness of these forms of creditor protection. It is interesting to note that both Canada and the United States lack federal statutory law governing insolvent trading.

B. Diversity in Employee Entitlements Laws in Selected Jurisdictions

When companies collapse, employees can miss out on entitlements, including unpaid wages, holiday pay, redundancy payments, pay in lieu of long-service leave, and superannuation contributions. Employees are even more vulnerable to corporate failure than unsecured creditors for two reasons. First, they lack the ability to diversify the investment of their labor by holding multiple jobs, and second, they not only lose the amounts owed to them but also their wages from week to week.

²¹⁷ Enterprise Bankruptcy Law (promulgated by Presidential Order No. 54, Aug. 27, 2006, effective June 1, 2007), art. 125, LAWINFOCHINA (last visited Oct. 14, 2008) (P.R.C.).

²¹⁸ *Id.* arts. 33-34.

²¹⁹ *Id.* art. 36.

²²⁰ Criminal Law (promulgated by Presidential Order No. 27, Dec. 25, 1999, effective Dec. 25, 2007) (amended 1999), art. 168, LAWINFOCHINA (last visited Oct. 14, 2008) (P.R.C.) provides that where an employee of a state-owned company or enterprise is gravely derelict in the exercise of his or her duties or is abusing his or her powers, causing bankruptcy or heavy losses to the company or enterprise which results in heavy losses of the state's interests, he or she shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention, or to fixed-term imprisonment of not less than three years but not more than seven years in very serious cases.

²²¹ See Song, *supra* note 78.

²²² [Commercial Code, Act No. 5591] art. 401-2 § (1)-(2) (1998) (S. KOR.).

Because of this vulnerability, as well as the strength in some countries of the trade union movement, it might be expected that corporations statutes would provide comprehensive protection of employee entitlements. However, this is not the case.

In Australia,²²³ employees, although unsecured creditors, enjoy a small measure of priority in distributions made by the liquidator when a company fails and is wound up in liquidation.²²⁴ However, this priority may not be sufficient to ensure their proper compensation.²²⁵ As a result of a public outcry in the wake of a series of prominent corporate failures, Australia introduced two measures for the protection of employees.

The first is Part 5.8A of the Corporations Act,²²⁶ which enables the liquidator to recover compensation from a "person"²²⁷ who has entered into an agreement or transaction with the intention of preventing the recovery of entitlements of employees of a company, or of significantly reducing the amounts of entitlements that can be recovered.²²⁸ Criminal penalties also apply.²²⁹ While the provision may appear harsh, the requirement to prove subjective intent significantly diminishes its effectiveness. There has not been a single successful claim under these provisions in the eight years since the legislation was introduced. In addition, while employees themselves may take action against a director with respect to their loss, they require the liquidator's permission and must wait six months or more after the company has commenced winding up.²³⁰

The ineffectiveness of this legislation prompted a taxpayer-funded scheme called the General Employee Entitlements and Redundancy Scheme ("GEERS"), which pays a portion of the entitlements of employees that have been lost upon their employer's liquidation.²³¹ While this scheme is beneficial to employees, it arguably undermines the incentive for directors to

²²³ See Wheelwright, *supra* note 6.

²²⁴ Corporations Act, 2001, No. 50, part 5.6, div. 6, sub. div. D § 556 (Austl.) (as amended). In the United States, liquidation is known as bankruptcy.

²²⁵ Priority in winding up means that the liquidator ensures that creditors in designated categories under § 556 are paid their entitlements before lower ranked creditors are paid anything. The existence of General Employee Entitlements and Redundancy Scheme ("GEERS"), discussed *infra* note 231 and accompanying text, provides evidence of the fact that in many cases, the employees of a company are insufficiently compensated by virtue of their priority when the company is wound up.

²²⁶ Corporations Act, 2001, Part 5.8A, § 596AA-AI (Austl.) (as amended) (This was inserted into the Corporations Act by the Corporations Law Amendment (Employee Entitlements) Act, 2000 (Austl.).)

²²⁷ *Id.* § 596AC. This term is not defined for the purpose of this section, but includes a director.

²²⁸ *Id.* § 596AB.

²²⁹ *Id.* part 9.4, div. 2 § 1311, Sched. 3. These are a fine of up to \$110,000 or imprisonment for 10 years, or both.

²³⁰ *Id.* part 5.8A, § 596AG.

²³¹ See generally GEERS <http://www.workplace.gov.au/workplace/Programmes/EmployeeEntitlements/GEERSV2/> (last visited May 6, 2008). There are limits on what employees may recover.

make adequate provision for employee entitlements prior to the company's insolvency.

Canada,²³² by way of contrast, has considerably more generous provisions than Australia. Federal, provincial and territorial statutes specify that directors may be held personally liable for employee entitlements²³³ for a prescribed period.²³⁴ The provisions become relevant when the corporation fails to pay these entitlements, usually in the lead up to insolvency.²³⁵ Section 119(1) of the *Canada Business Corporations Act 1985* ("CBCA") is an example:

Directors of a corporation are jointly and severally, or solidarily, liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.²³⁶

Pursuant to § 119(3), the director must be sued within two years after ceasing to be a director.²³⁷ A due diligence defence applies under the CBCA.²³⁸ Directors who pay employee entitlements under these provisions are then subrogated to the rights of the employees in terms of priority of recovery from the company's liquidated assets.²³⁹

Section 234(2) of the *Employment Relations Act 2000* governs liability with respect to certain unpaid employee entitlements in New Zealand. The section provides:

²³² See Sarra, *supra* note 17.

²³³ See *Barrette v. Crabtree Estate*, [1993] 1 S.C.R. 1027 (Can.). However, severance pay is not included. It is considered to be a payment arising from breach of contract, and not from services rendered. However, where a collective agreement guarantees the payment of severance pay on dismissal based on a formula of service, it may be included in the claim against the directors. See, e.g., *Schwartz v. Scott*, [1985] C.A. 713, 32 B.L.R. 1 (Can.).

²³⁴ See, e.g., *Canada Business Corporations Act*, R.S.C., c. C-44 (1985). Related compensation can include vacation pay and guaranteed bonuses. *Mills-Hughes et al. v. Raynor et al.*, [1988] 63 O.R.2d 343, 730(n) (Can.).

²³⁵ The *Canada Business Corporations Act*, R.S.C., 1985, c. C-44 § 119(2) (1985) provides that: "A director is not liable under subsection (1) unless (a) the corporation has been sued for the debt within six months after it has become due and execution has been returned unsatisfied in whole or in part; (b) the corporation has commenced liquidation and dissolution proceedings or has been dissolved and a claim for the debt has been proved within six months after the earlier of the date of commencement of the liquidation and dissolution proceedings and the date of dissolution; or (c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the debt has been proved within six months after the date of the assignment or bankruptcy order."

²³⁶ *Canada Business Corporations Act*, R.S.C., c. C-44, § 119(1) (1985).

²³⁷ *Id.* § 119(3).

²³⁸ *Id.* § 123.

²³⁹ *Id.* § 119(5).

Where . . . the Labour Inspector establishes on the balance of probabilities that the amount claimed in the action by way of minimum wages or holiday pay²⁴⁰ or both is, if judgment is given for that amount, unlikely to be paid in full, whether because—

(a) the company is in receivership or liquidation; or

(b) there are reasonable grounds for believing that the company does not have sufficient assets to pay that amount in full,—

the Authority may authorise the Labour Inspector to bring an action for the recovery of that amount against any officer, director, or agent of the company who has directed or authorised the default in payment of the minimum wages or holiday pay or both.²⁴¹

Liability is joint and several,²⁴² and is initiated by Labour Inspector commencing proceedings in the Employment Relations Authority against the company for the payment of the relevant amounts. The Employment Relations Authority then has discretion to authorise the Labour Inspector to bring the recovery action against the director.

In South Africa, employers are required to withhold and pay over contributions on behalf of their employees, pursuant to the Unemployment Insurance Contributions Act 2002. Directors are personally liable for any amount withheld and not paid over, in addition to penalties.²⁴³ There are no defences available.²⁴⁴

In Hong Kong,²⁴⁵ directors are not liable for unpaid employee entitlements upon corporate insolvency. Where employees are owed wages and other specified entitlements,²⁴⁶ the Protection of Wages on Insolvency Ordinance may make *ex gratia* payments to applicants.²⁴⁷ A fund established under § 6 of that Ordinance is made up of business registration fees²⁴⁸ and other specified monies. Similarly, in the United Kingdom,²⁴⁹ the

²⁴⁰ These are provided for under the Minimum Wages Act 1983, 1983 S.N.Z. No. 115 (N.Z.) or the Holidays Act 2003, 2003 S.N.Z. No. 129 (N.Z.).

²⁴¹ Employment Relations Act 2000, 2000 S.N.Z. No. 24, § 234(2) (N.Z.).

²⁴² *Id.* § 234(3).

²⁴³ Unemployment Insurance Contributions Act of 2002 s. 7(4) (S. Afr.).

²⁴⁴ *Id.*

²⁴⁵ See Goo et al., *supra* note 54.

²⁴⁶ These are wages in lieu of notice and severance pay.

²⁴⁷ Protection of Wages on Insolvency Ordinance, (1985) Cap. 380, § 16. (H.K.).

²⁴⁸ These are paid under the Business Registration Ordinance, (1997) Cap 310, § 21. (H.K.).

²⁴⁹ See Lowry, *supra* note 75.

Employment Rights Act of 1996²⁵⁰ establishes the National Insurance Fund. This pays amounts of unpaid wages, accrued entitlements, payment in lieu of notice, and redundancy pay.

In summary, there is little legislation to ensure the protection of employee entitlements across the jurisdictions surveyed, and what legislation there is, with the exception of Canada, is inadequate to ensure these vulnerable corporate stakeholders are compensated for their losses. It is noteworthy that a number of jurisdictions, such as Australia, the United Kingdom, and Hong Kong, have introduced taxpayer-funded schemes to provide partial compensation to unpaid employees upon corporate insolvency.

C. *Diversity in Tort Laws in Selected Jurisdictions*

Next, this article briefly examines tort law across jurisdictions. It is presented as a contrast to the varied statutory provisions examined above. Interestingly, in the absence of individual national legislation, some of the Commonwealth countries discussed above have developed law which is an amalgam of the case law decided in these countries. However, the weakness of this development is that there is general dissatisfaction with the state of the law, as well as confusion as to the appropriate test to apply in any given situation. South Africa, by way of contrast, avoids all of the judicial gymnastics of the Commonwealth countries by imposing liability on directors regardless of the fact that their actions were undertaken in their capacities as directors.

Like unsecured creditors and employees, tort creditors are vulnerable corporate stakeholders. In the event of insolvency of the defendant company, tort claimants generally have no resort to a compensation fund²⁵¹ and may face ongoing personal injury expenses. Arguably, those who suffer financial loss as a result of the tortious conduct of company officers, for example directors making negligent misrepresentations at the time of making contracts, should enjoy the same degree of protection as those investing in companies via a prospectus. Yet the difference in the degree of legislative safeguards in these two areas could not be more stark. Tort claimants in the jurisdictions discussed below must rely on common law to establish their claims against directors, who, in many instances, successfully

²⁵⁰ Employment Rights Act, (1996) (U.K.).

²⁵¹ New Zealand is an exception, with its Accident Compensation Corporation for personal injury victims. See Accident Compensation Corporation, <http://www.acc.co.nz/index.htm> (last visited Nov. 28, 2008).

shield themselves behind the separate legal entity of the company and the concept of limited liability.

As shown below, directors' ability to successfully avoid liability has in part been caused by a misunderstanding or misuse of fundamental legal doctrines.²⁵² The concept of limited liability relates to the liability of shareholders, not directors. Shareholders' liability is limited, in the event of a winding up, to the amount unpaid, if any, on their shares.²⁵³ The concept is not relevant to the liability of directors or employees or anyone else who acts on behalf of a company.²⁵⁴

If corporate servants or agents commit a tort whilst acting on behalf of the company, they are personally liable for their actions, and liability is also attributed to the company. This doctrine of vicarious liability ensures that the plaintiff has a viable defendant. In the event of the company's insolvency, however, the responsibility to pay the tort victim remains solely with the tortfeasor. Nonetheless, where that tortfeasor is a director, the argument is sometimes made that the person was acting as the "directing mind and will" of the company, so that personal liability should not attach.²⁵⁵ This is known as the organic theory. However, in Commonwealth countries, according to Stephen J. in the *High Court of Australia in Smorgon v. Australia and New Zealand Banking Group Ltd.*,²⁵⁶ "it has been in areas in which the ends of justice have been thought to require the attribution of mental states that the organic theory has been employed and developed."²⁵⁷ In other words, the fact that the director acted as the company is relevant for attributing his or her mental intent to the company, for the purpose of establishing liability on the part of the company where a mental element is required. It is not intended to relieve that director of personal liability. Confusion over the meaning of attribution has led to many of the difficulties in the cases outlined below.

²⁵² See generally, Helen Anderson, *The Theory of the Corporation and Its Relevance to Directors' Tortious Liability to Creditors*, 16 AUSTL. J. CORP. L. 73.

²⁵³ See, e.g., Corporations Act, 2001, § 516 (Austl.).

²⁵⁴ See, e.g., Susan Watson & Andrew Willekes, *Economic Loss and Directors' Negligence*, J. BUS. L. 217, 218 (2001).

²⁵⁵ See G.H.L. Fridman, *Personal Tort Liability of Company Directors*, 5 CANTERBURY L. REV. 41, 54 (1992). Neyers cites as a common misconception of the function of the organic theory that "once liability is attributed to the separate legal person through the actions of its 'vital organs,' the constituent directors are somehow 'washed clean' of legal responsibility." Jason W. Neyers, *Canadian Corporate Law, Veil Piercing and the Private Law Model Corporation*, 50 U. TORONTO L. J. 173, 228 (2000). See also Ross Grantham, *Commentary on Goddard*, in CORPORATE PERSONALITY IN THE 20TH CENTURY 65, 68-69 (Ross Grantham & Charles Rickett eds. 1998).

²⁵⁶ *Smorgon v. Australia and New Zealand Banking Group Ltd.* (1976) 134 C.L.R. 475, 483 (Austl.).

²⁵⁷ This follows Lord Hoffman's judgment in the United Kingdom in *Meridian Global Funds Management Asia Ltd. v. the Securities Commission*, (1995) 2 A.C. 500, 505 (U.K.).

Within the Commonwealth countries, there are four different tests courts use to determine the personal liability of directors in tort. Australia has relatively few cases on point, and these draw heavily on precedents from other Commonwealth jurisdictions. The “direct or procure” test is the most common, and has been used in Britain, Canada, New Zealand, and Australia since the development of liability of directors for company torts. It is also the test most favorable to plaintiffs, and has been used for the torts of negligence, breach of copyright, nuisance, deceit, and conversion. The “make the tort his own” test was first applied in 1978 and has been used in Canada, Britain, and Australia, principally in copyright, passing off, and patent cases, and is more difficult to make out. The “assumption of responsibility” test, which was first applied in 1992, has been used in Britain and New Zealand, mainly in negligent misstatement cases. Commentators discussing the law relating to a director’s personal liability to creditors in tort generally confine themselves to these three tests.²⁵⁸ However, a number of recent cases rely on a fourth rule originating from the decision in *Said v. Butt*,²⁵⁹ to find that directors are not liable for the tort of procuring a breach of contract that they commit while acting for the company.

Commonwealth courts have been troubled by the dual roles of directors—as people and as the directing mind and will of companies. Le Dain J. summed up the dilemma facing courts thus:

On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. On the other hand, there is the principle that everyone should answer for his tortious acts.²⁶⁰

Each of the tests will now be briefly examined. The first is the “direct or procure” test. It originally sought to attribute liability to a director for the tortious actions of a more junior person in the company, where those actions

²⁵⁸ See, e.g., John H. Farrar, *The Personal Liability of Directors for Corporate Torts*, 9 BOND L. REV. 102 (1997), available at <http://epublications.bond.edu.au/blr/vol9/iss1/6/>; Francis Reynolds, *Personal Liability of Company Directors in Tort*, 33 HONG KONG L.J. 51 (2003); Andrew Borrowdale, *Directors’ Liability in Tort*, N. Z. L.J. 51(1999); Susan Watson & Andrew Willekes, *Economic Loss and Directors’ Negligence*, J. BUS. L. 217 (2001).

²⁵⁹ *Said v. Butt*, [1920] 3 K.B. 497 (U.K.).

²⁶⁰ *Mentmore Manufacturing Co. Ltd. v. National Merchandising Manufacturing Company Inc.*, [1978] 89 D.L.R. (3d) 195, 203 (Can.).

are directed or procured by the director.²⁶¹ Later courts, however, have frequently used the expression “direct or procure” to hold a director liable for his own actions.²⁶²

The “make the tort his own” test originated in Canada in *Mentmore Manufacturing Co. Ltd. v. National Merchandising Manufacturing Company Inc.*²⁶³ Le Dain J. of the Federal Court of Appeal of Canada found that cases warranting personal liability exhibited “a knowing, deliberate, wilful quality to the participation,” “that degree and kind of personal involvement by which the director or officer makes the tortious act his own.”²⁶⁴

The third test, of “assumption of responsibility,” was outlined in the New Zealand decision in *Trevor Ivory Ltd. and Trevor Ivory v. Anderson*,²⁶⁵ a case of negligent misstatement involving a one-man company. Hardie Boys J. said:

Essentially, I think the test is, or at least includes, whether there has been an assumption of responsibility, actual or imputed. That is an appropriate test for the personal liability of both a director and an employee Assumption of responsibility may well arise or be imputed where the director or employee exercises particular control or control over a particular operation or activity, . . . This is perhaps more likely to arise within a large company where there are clear allocations of responsibility, than in a small one.²⁶⁶

His Honour then commented that the use of a company to carry on the business could be seen as a personal disclaimer, rather than the basis for

²⁶¹ It is well accepted that employees are liable in tort for their actions as part of their employment. Given that they are more likely to be acting under others' instructions, it seems ironic that this liability is unchallenged, yet the liability of those who give the instructions is contentious. Even employees performing the “very essence” of their contract can be held personally liable in tort, according to the Supreme Court of Canada in *London Drugs Ltd. v. Kuehne & Nagel Int'l Ltd.*, [1992] 3 S.C.R. 299, (Can.). Iacobucci J. there stated: “There is no general rule in Canada to the effect that an employee acting in the course of his or her employment and performing the ‘very essence’ of his or her contractual obligations with a customer does not owe a duty of care, whether one labels it ‘independent’ or otherwise, to the employer’s customer.” *Id.* at 407-08.

²⁶² In *Standard Chartered Bank v. Pakistan National Shipping Corp. (No 2)*, [2002] UKHL 43, [2003] 1 A.C. 959, Lord Rodger described the use of the “direct or procure” test to ascribe liability for director’s own actions as “strangely complex.”

²⁶³ *Mentmore Manufacturing Co. Ltd. v. National Merchandising Manufacturing Company Inc.*, [1978] 89 D.L.R. (3d) 195 (Can.).

²⁶⁴ *Id.* at 204.

²⁶⁵ *Trevor Ivory Ltd. and Trevor Ivory v. Anderson*, [1992] 2 N.Z.L.R. 517 (N.Z.). This decision built on the earlier decision in *Fairline Shipping Corp. v. Adamson*, [1975] Q.B. 180 (N.Z.). See generally John H. Farrar, *The Personal Liability of Directors for Corporate Torts*, 9 BOND L. REV. 102, 109 (1997).

²⁶⁶ *Trevor Ivory Ltd. and Trevor Ivory v. Anderson*, [1992] 2 N.Z.L.R. 517, 527 (N.Z.).

imputing an assumption of responsibility.²⁶⁷ In other words, why else would someone incorporate himself, as in *Salomon v. Salomon & Co. Ltd.*,²⁶⁸ if not to escape from personal responsibility and liability?²⁶⁹

The fourth rule arose from *Said v. Butt*,²⁷⁰ in which plaintiff brought action against the managing director of a theatre company for wrongfully and maliciously procuring the company to breach its contract with the plaintiff, by refusing him entry after he had purchased a ticket to enter the theatre. Rather than providing a test of general application, the case simply stands for the proposition that directors cannot be liable for the tort of procuring a breach of contract which they commit while acting for the company.

In Australia, courts have been unable to decide which test to apply.²⁷¹ *Root Quality Pty Ltd. v. Root Control Technologies Pty. Ltd.* examined and criticized each test.²⁷² The tests were also canvassed extensively in 2003 in *Johnson Matthey (Aust) Pty Ltd. v. Dascorp Pty. Ltd.*²⁷³ *Root Quality* concluded that the director must be shown to have directed or procured the tortious conduct of the company.²⁷⁴ In *King v. Milpurrurru*, the court laid down a stricter test requiring that the defendant make the tort his own by deliberately and knowingly pursuing the course of conduct that constituted the breach.²⁷⁵

Courts differ as to the extent of each test's application, and as to its relevant factors. Even though under the "direct or procure" test, Australian courts generally agree that the holding of an office, such as director or even managing director, does not itself render the office holder liable for the torts

²⁶⁷ *Id.* at 528.

²⁶⁸ *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22 (H.L.) (U.K.).

²⁶⁹ In *Oakley Inc. v. Oslu Imports and Exports Pty. Ltd.*, [2000] F.C.A. 700, 35, Finn J. said, citing *Mentmore, Trevor Ivory and Williams*, that "such are both the controversies surrounding it in the common law world and its implications for small companies . . . that, in the absence of argument directed to the foundation of the tort—and in particular to whether it properly is to be regarded in the present setting as an intentional tort—I am not prepared to assume liability from the fact that, as the company's alter ego, Mr. Tao directed the actions that gave rise to the infringements."

²⁷⁰ *Said v. Butt*, [1920] 3 K.B. 497 (U.K.).

²⁷¹ In *G. M. (North Melbourne) v. Young Kelly* (1986) 7 I.P.R. 149, 158 directors' liability for their tortious actions on behalf of their companies was described as a complex and burgeoning field of the law. In *Root Quality v. Root Control Technologies Pty. Ltd.* (2000) 177 A.L.R. 231, 115 (Austl.), Finklestein J. called it a "confusing picture on an issue that has persistently vexed the common law". See generally Helen Anderson, *The Theory of the Corporation and Its Relevance to Directors' Tortious Liability to Creditors*, 16 AUSTL. J. CORP. L. 73; Helen Anderson, *Directors' Personal Liability to Creditors: Theory versus Tradition*, 8 DEAKIN L. REV. 209 (2003).

²⁷² *Root Quality v. Root Control Technologies Pty. Ltd.* (2000) 177 A.L.R. 231 (Austl.).

²⁷³ *Johnson Matthey (Aust) Pty Ltd. v. Dascorp Pty Ltd.* (2003) V.S.C. 291 (Austl.).

²⁷⁴ *Root Quality v. Root Control Technologies Pty. Ltd.* (2000) 177 A.L.R. 231 (Austl.); *Microsoft Corp. v. Auschina Polaris Pty. Ltd.* (1996) 142 A.L.R. 111 (Austl.).

²⁷⁵ *King v Milpurrurru* (1996) 34 I.P.R. 11 (Austl.).

of the company, the actual degree of involvement required is unresolved. Personal liability is not dependent on the director knowing that the conduct is in fact tortious, but there is no agreement as to the extent of involvement required of the director. In *Autocaps (Austl.) Pty. Ltd. v. Pro-Kit Pty Ltd.*,²⁷⁶ the director was liable as the person “in charge of its affairs” and with knowledge of the offending behaviour. *Martin Engineering Co v. Nicaro Holdings Pty. Ltd.*²⁷⁷ described the director as the “moving spirit.”²⁷⁸ In *Australasian Performing Right Association Ltd. v. Jain*,²⁷⁹ a director was liable for “countenancing” the breach. As such, the law in Australia remains unsettled, and it is difficult to predict which test will be applied in a given fact situation.

Canada²⁸⁰ is similar to Australia in relation to the imposition of personal liability on directors, in that judicial opinion on the matter diverges. The Federal Court of Appeal in *Mentmore, supra*, noted that formulating a test of general application is a difficult task, and that courts will have “regard to the particular circumstances of each case to determine whether as a matter of public policy they call for personal liability.”²⁸¹

While *Mentmore* laid down the “make the tort his own” test,²⁸² the Court of Appeal of Ontario applied the *Said v. Butt* rule²⁸³ in *ADGA Systems International Ltd. v. Valcom Ltd.*²⁸⁴ Carthy J.A. found that the rule:

provides an exception to the general rule that persons are responsible for their own conduct. . . . The exception also assures that officers and directors, in the process of carrying on business, are capable of directing that a contract of employment be terminated or that a business contract not be performed on the assumed basis that the company’s best interest is to pay damages for failure to perform. By carving out the exception for these policy reasons, the court has emphasized and left

²⁷⁶ *Autocaps (Aust) Pty Ltd v Pro-Kit Pty Ltd.* (1999) 46 I.P.R. 339 (Austl.).

²⁷⁷ *Martin Engineering Co v. Nicaro Holdings Pty Ltd.* (1999) 100 A.L.R. 358 (Austl.).

²⁷⁸ “Moving spirit” is the expression also used by Sundberg J. in *Pioneer Electronics Australia Pty Ltd. v. Lee* (2000) 108 F.C.R. 216, 46 (Austl.), in finding a director liable for the torts of breach of copyright and passing off. His Honour looked at the various tests of liability, commenting that “[t]he law on the personal liability of a director for corporate torts is in an uncertain state. There seem to be at least four views having judicial support.” *Id.* at 45. He noted that the director “directed and promoted” the breaches. *Id.* at 46 (emphasis added).

²⁷⁹ *Australasian Performing Right Association Ltd v. Jain* (1990) 26 F.C.R. 53 (Austl.).

²⁸⁰ See Sarra, *supra* note 17.

²⁸¹ *Mentmore Manufacturing Co. Ltd. v. National Merchandising Manufacturing Company Inc.*, [1978] 89 D.L.R. (3d) 195, 203 (Can.).

²⁸² *Id.* at 204.

²⁸³ *Said v. Butt*, [1920] 3 K.B. 497 (U.K.).

²⁸⁴ *ADGA Systems Int’l. Ltd v. Valcom Ltd.*, [1999] 168 (4th) D.L.R. 351 (O.A.C.) (Can.) (Ont.).

intact the general liability of any individual for personal conduct.²⁸⁵

The court found that this exception applies where the directors are procuring a breach of a contract to which *their own company* is a party. Carthy J.A. found on the facts that the directors of a company which intentionally procured the breach of contract of employees of *another* company, in a recruitment exercise, were personally liable for the tort.²⁸⁶ In addition, despite the *Said v. Butt*²⁸⁷ exception, Carthy J.A. stressed the consistent line of Canadian authority which holds that “in all events, officers, directors and employees of corporations are responsible for their tortious conduct even though that conduct was directed in a *bona fide* manner to the best interests of the company.”²⁸⁸

In New Zealand,²⁸⁹ the assumption of responsibility rule from *Trevor Ivory*²⁹⁰ is now being applied beyond negligent misstatement cases to “leaky building” cases.²⁹¹ The test has been used as an obstacle to property damage claims against directors, although it was distinguished in *Dicks v. Hobson Swan Construction Ltd. (In Liq.)*,²⁹² on the basis of the director’s actual involvement in the project.²⁹³

In the United Kingdom,²⁹⁴ a similar debate on the personal liability of a director qua director in tort has arisen. The House of Lords,²⁹⁵ in *Williams v. Natural Life Health Food Ltd. and Mistlin*,²⁹⁶ upheld the “assumption of

²⁸⁵ *Id.* at 357.

²⁸⁶ *Id.* Similar facts led to the same result in *Multinail Australia Pty Ltd v. Pryde (Austl.) Pty Ltd.*, (2002) Q.S.C. 105 (Austl.). Chesterman J. confined the rule in *Said v. Butt* to cases where the director procured a breach of their own company’s contract, finding that the “direct or procure” test was applicable otherwise. *Id.* at 126.

²⁸⁷ *Said v. Butt*, [1920] 3 K.B. 497 (U.K.).

²⁸⁸ *ADGA Systems Int’l. Ltd v. Valcom Ltd.*, [1999] 168 (4th) D.L.R. 351 (O.A.C.) (Can.) (Ont.).

²⁸⁹ See Noonan & Watson, *supra* note 28.

²⁹⁰ *Trevor Ivory Ltd. and Trevor Ivory v. Anderson*, [1992] 2 N.Z.L.R. 517 (N.Z.).

²⁹¹ *Id.* See also Samuel D. Carpenter, *Directors’ Liability and Leaky Buildings*, N. Z. L.J. 117 (Apr. 2006); N. Campbell, *Leaking Homes, Leaking Companies*, [2002] C.S.L.B. 101.

²⁹² *Dicks v. Hobson Swan Construction Ltd (In Liq.)*, [2006] 7 N.Z.C.P.R. 881 (H.C.) (N.Z.) (Auck.) (Baragwanath J).

²⁹³ In the last 15 years in New Zealand, there has been increasing amounts of litigation to recover damages for newly built homes that subsequently suffer water damage. Action has been taken against builders and developers to recover damages for economic loss, including remedial works, building consultants’ fees, accommodation costs, travelling costs and other consequential costs of the remedial works. In a series of cases, New Zealand courts have looked at whether the directors of building companies have assumed personal responsibility for the building projects.

²⁹⁴ See Lowry, *supra* note 75.

²⁹⁵ Lord Steyn, with Lord Goff, Lord Hoffman, Lord Clyde and Lord Hutton concurring.

²⁹⁶ *Williams et al. v. Natural Life Health Foods Ltd. et al.*, [1980] 1 W.K.L. REP. 830 (U.K.). See also Ross Grantham & Charles Rickett, *Directors’ ‘Tortious’ Liability: Contract, Tort or Company Law?*, 62 MODERN L. REV. 133 (1999); Andrew Borrowdale, *Directors’ Liability in Tort*, N. Z. L. J. 51 (1999).

responsibility” test in a case of negligent misstatement. Lord Steyn acknowledged the potential for director liability by noting that “whether the principal is a company or a natural legal person, someone acting on his behalf may incur personal liability in tort as well as imposing vicarious or attributed liability upon his principal.”²⁹⁷ Lord Steyn held that neither the defendant’s state of mind nor his internal arrangements with his company were relevant to the inquiry. Instead, of relevance was “whether the director, or anybody on his behalf, conveyed directly or indirectly to the prospective franchisees that the director assumed personal responsibility towards”²⁹⁸ them.

Approving *Trevor Ivory*,²⁹⁹ Lord Steyn found that where a director acts in the capacity of director, he will not be liable. His Lordship considered that the finding of a *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*³⁰⁰ “special relationship”³⁰¹ between plaintiff and company is not the same as one between plaintiff and director. The key issue was whether the director had acted in a way that exceeded his corporate authority as a director, so that any accountability for the tortious act became his alone. He stated:

in order to establish personal liability under the principle of *Hedley Byrne*, which requires the existence of a special relationship between plaintiff and tortfeasor, it is not sufficient that there should have been a special relationship with the principal. There must have been an assumption of responsibility such as to create a special relationship with the director or employee himself.³⁰²

Dealing with criticisms of the assumption of responsibility test, Lord Steyn said:

Returning to the particular question before the House it is important to make clear that a director of a contracting company may only be held liable where it is established by evidence that he assumed personal liability and that there was

²⁹⁷ *Williams et al. v. Natural Life Health Foods Ltd. et al.*, [1980] 1 W.K.L. REP. 830, 835 (U.K.).

²⁹⁸ *Id.*

²⁹⁹ *Trevor Ivory Ltd. and Trevor Ivory v. Anderson*, [1992] 2 N.Z.L.R. 517 (N.Z.).

³⁰⁰ *Hedley Byrne & Co Ltd v. Heller & Partners Ltd.*, [1964] A.C. 465. (H.L. 1963).

³⁰¹ *Id.* In *Hedley Byrne*, the court found that the relationship between the parties was “sufficiently proximate” as to create a duty of care. This was based on the court’s finding that it was reasonable for the defendants to have known that the information that they had given would be likely to have been relied upon in forming a contract. The court stated that this would give rise to a “special relationship,” where the defendant would be required to take sufficient care in giving advice to avoid liability in negligence.

³⁰² *Williams et al. v. Natural Life Health Foods Ltd. et al.*, [1980] 1 W.K.L. REP. 830, 835 (U.K.).

the necessary reliance. There is nothing fictional about this species of liability in tort.³⁰³

The law, however, is not settled. In the *Standard Chartered Bank* case, Lord Hoffmann rejected the earlier appellate view,³⁰⁴ stating that “[n]o one can escape liability for fraud by saying ‘I wish to make it clear that I am committing this fraud on behalf of someone else and I am not to be personally liable.’”³⁰⁵

In Malaysia, it is rare to find cases holding directors personally liable for the tortious actions of their companies. One such decision is *Victor Cham v. Loh Bee Tuan*.³⁰⁶ In that case, the Court found a director personally liable for deceit in relation to fraudulent misrepresentations contained in a sale and purchase document prepared by his company. The Court applied English authorities³⁰⁷ in determining that the director had authorised or procured the company to commit the fraudulent misrepresentation.³⁰⁸

South Africa contrasts starkly with the jurisdictions discussed above. The law of delict, as tort law is known in South Africa, has no difficulty attributing personal liability to directors, even if directors are simply carrying out their duties on behalf of the company. The issue of whether the directors directed or procured the wrongful act of the company therefore does not arise in South African company law.³⁰⁹

South Korea adopts a different method to find directors liable for their actions. The Korean Commercial Code provides that:

(1) If directors have acted in contravention of any law or regulation, or of the articles of incorporation or has neglected to perform their duties, they [such director] shall be jointly and

³⁰³ *Id.* at 830, 837.

³⁰⁴ *Standard Chartered Bank v. Pakistan National Shipping Corp.*, [2001] 1 Lloyd’s Rep. 218, 233 (U.K.) (Aldous LJ).

³⁰⁵ See *Standard Chartered Bank v. Pakistan National Shipping Corp and others*, 1 BUTTERWORTHS COMPANY LAW CASES 252, 244-259 (D.D. Prentice ed., 2003).

³⁰⁶ *Victor Cham v. Loh Bee Tuan* [2006] 5 M.L.J. 359, [13] (Malay.).

³⁰⁷ See *Rainham Chemical Works Ltd. v. Belvedere Fish Guano Co Ltd.*, [1921] All E.R. 48 (U.K.); *Performing Rights Society Ltd. v. Caryl Theatrical Syndicate Ltd.*, [1924] 1 K.B. 1 (U.K.).

³⁰⁸ See also *Loh Bee Tuan v. Shing Yin Construction (Kota Kinabalu) Sdn Bhd* [2002] 2 M.L.J. 532, [540] (Malay.). In *Victor Cham v. Loh Bee Tuan* [2006] 5 M.L.J. 359, [366] (Malay.), the court referred to and approved of the decision of the Privy Council in *Wah Tat Bank Ltd. v. Chan Cheng Kum* [1975] 2 All E.R. 257 (S. Ct.) (Malay.). In that case, Lord Salmon, *id.* at 272, applied the “direct or procure” test in imposing personal liability on the director.

³⁰⁹ See M. Havenga, *Directors’ Co-liability for Delicts*, 18 S. AFR. MERCANTILE L. J. 229 (2006).

severally liable for damages to the company [emphasis added]
[resulting from such acts or omissions].³¹⁰

Directors are also liable when the act in question is done in accordance with a resolution of the board, and they have either assented to the resolution, or failed to enter their dissenting opinion into the company minutes. While the director is liable to the company and not to any outside party, a party affected by the directors' negligence or other fault sues the company, and then the company recoups this amount from the director.³¹¹

In summary, the law protecting tort claimants is diverse and unsatisfactory in many jurisdictions. The lack of legislative protection of this group of most vulnerable corporate stakeholders is remarkable. One could cynically conclude that legislatures are not in fact interested in deterrence and compensation of those adversely affected by corporate misbehavior, unless their contact with the company is voluntary and there are potentially large numbers of people involved. Investors might be dissuaded from providing capital to companies without adequate safeguards. Because this would have adverse economic effects, there is an incentive to enact stringent provisions to encourage investor confidence. The foregoing discussion shows that jurisdictions around the world have come to the same conclusion.

Tort claimants, on the other hand, are involuntary, likely to be few in number, and have no economic value to add to the corporation. Yet it is noteworthy that even contract creditors who have voluntarily entered into dealings with companies have not received more favourable treatment from the courts; indeed, in some cases, their consent to deal with a limited liability entity has been counted as a factor *against* a finding of liability on the part of the tortfeasor director.³¹² Contrast this with the position of an investor in a limited liability corporation, armed with an entire prospectus before deciding to invest.

D. *Conclusion on Diversity of Laws in Selected Jurisdictions*

This Part has looked at three areas of law where there is considerable dissimilarity among jurisdictions. Insolvent trading, which acts to protect unsecured trade creditors, has wide international variations. Many countries

³¹⁰ Commercial Code, 2 CURRENT LAWS OF THE REPUBLIC OF KOREA 641 (Korea Legislation Research Institute 1962) (emphasis added).

³¹¹ *Id.* § 399 (1).

³¹² See also H. Anderson, *The Theory of the Corporation and Its Relevance to Directors' Tortious Liability to Creditors*, 16 AUSTRALIAN J. CORP. L. 73 (2004).

require fault, sometimes in terms of fraud, negligence, recklessness, or breach of duty. The format of the various pieces of legislation differs as well. Even in Australia under an apparently stringent legislative regime, parties face difficulties in terms of recovery. Canada, unlike other Commonwealth countries, has no insolvent trading laws at all.

Employee entitlements receive very limited legislative protection in the countries examined. Canada's regime, the most generous, imposes strict liability, subject to a due diligence defence. As noted in Part C, *supra*, the subjective element in Australia's test renders it useless, necessitating a government assistance scheme funded by taxpayers. New Zealand's scheme relies on the initiative of a government official, and is limited in the amounts recoverable. The other countries looked at above have no laws imposing liability on directors.

The rights of tort claimants were examined in some of the Commonwealth countries. There is no relevant legislation, and courts have struggled to enunciate tests of general application. In part this is because of a misunderstanding of the laws of attribution. The director is seen as the directing mind and will of the company, and therefore his actions become the actions of the company itself, rather than his own. Something special needs to be done to make the director personally liable for the tort, such as "making the tort his own" or an assumption of personal responsibility.

There is no question that company employees committing torts are personally liable for their actions, in addition to the company being vicariously liable. Directors' liability for their own tortious conduct is recognized in jurisdictions such as South Africa and South Korea. There is nothing in the doctrine of limited liability or separate legal entity that prevents a director's actions from being attributed to the company for the purpose of making the company vicariously liable, *as well as* being a basis for personal liability. Indeed, this point is made abundantly clear in the examination of the legislation in Part II and in this Part. Recovery for tort claimants has been left to the vagaries of the common law, and the most significant problem for them is the lack of legislative will to entrench their rights of recovery. A possible reason for this will be discussed in the next Part.

IV. REASONS FOR SIMILARITY AND DIVERSITY

The preceding examination of the similarity and diversity of laws across various jurisdictions inevitably leads to the question of why this

should be so. Indeed, it is equally valid to question why they should be similar, as it is to exclaim their differences.

Nonetheless, it seems appropriate, after an extensive examination of these laws and jurisdictions, to speculate on why these laws are the way they are. What follows is a brief review of the literature on similarities and differences in laws, to suggest some possible reasons why the laws surveyed in Parts II and III above should be as they are. It does not attempt to draw any definitive conclusions.

It should be noted much of the comparative corporate law literature on convergence and divergence concentrates on the broader governance debate, rather than the narrower focus on directors' liability for their companies' faults and defaults. Still, the same forces appear to be applicable to the present enquiry. Broadly speaking, these can be summarized as political, economic, practical, and evolutionary (or path dependent).

Political influences both for and against similarity are numerous. They include pressure from interest groups and institutions,³¹³ such as business associations, trade unions, employer groups, consumer organizations, and local and international environmental lobbies.³¹⁴ While pressure may be to reform the law to acknowledge the needs of a group's particular constituents, often vested interests can actively work to protect themselves against legislative reform.³¹⁵ Responses to corporate scandals can result in knee-jerk legislative reform tailored to the particular situation,³¹⁶ as can a major environmental disaster.³¹⁷ The political persuasion of the incumbent government will also affect its stance on corporate law reform,³¹⁸ as will the extent to which law is made by the

³¹³ H. Hansmann & R. Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 453 (2000).

³¹⁴ These include the United Nations Environment Programme, Greenpeace, and the World Wild Fund for Nature, amongst many hundreds of others.

³¹⁵ Hansmann & Kraakman, *supra* note 313, at 459-460 (discussing the arguments made in Lucien Bebchuk & Mark Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999)).

³¹⁶ J. Hill, *The Persistent Debate about Convergence in Comparative Corporate Governance*, 27 SYDNEY L. REV. 743, 750 (2005). "[P]ost-Enron regulatory developments are a potent reminder that corporate events of this magnitude can generate new divergence in laws." Hill cites here the introduction in the United States of the Sarbanes Oxley legislation, and in Australia, of CLERP 9. "The architecture of these laws often directly tracks the contours of local scandals." *Id.* at 751. See also J. Hill, *Regulatory Responses to Global Corporate Scandals*, 3 WIS. INT'L L. J. 367 (2005).

³¹⁷ For example, the CERCLA laws in the United States, discussed *supra* Part II.C and note 155, which were enacted in response to the environmental damage caused at Love Canal.

³¹⁸ This can include calls to reduce the compliance burden on business, which can result in less legislative intervention in corporate business.

courts, as opposed to the legislature.³¹⁹ Some countries have more sophisticated theoretical frameworks and existing mechanisms, such as Law Reform Commissions and dedicated parliamentary committees, for the process of law reform than others.³²⁰

Other relevant political factors include whether the country is run by a democratically elected government or not,³²¹ levels of judicial and legislative accountability, and the overall transparency of the political process. This is not to say, however, that similar forms of government necessarily lead to identical or similar law. This has been borne out by the comparison of the laws of Australia, Canada, the United States, and the United Kingdom, where significant differences were noted. The law as it is applied can also differ from the “law on the books,” due to lack of political will to enforce it.³²² This is sometimes the result in a country into which law has been transplanted, perhaps by former colonial governors.³²³

There can also be implicit or explicit political pressures from outside the country to adopt certain laws, for example, in order to be accepted into a trade group or other alliance. The European Union is a good example of this phenomenon.³²⁴ Membership is in some instances contingent on adoption of harmonized laws, even though these are not always successful in the absence of supporting institutions and culture.³²⁵

³¹⁹ Katharina Pistor notes that “[l]egal systems that have facilitated this process of adaptation and were able to respond to new legal lacunae created by change have proved to be more successful over time. From the perspective of legal innovation, common law countries have been more successful than civil law countries” Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23(4) U. PA. J. INT’L ECON. L. 791, 794 (2002).

³²⁰ See, e.g., in Australia: the Australian Law Reform Commission, the Parliamentary Joint Committee on Corporations and Financial Services, and the Companies and Markets Advisory Committee; in New Zealand: the Law Commission; in Malaysia: the Corporate Law Reform Committee, and the High Level Finance Committee; in Hong Kong: the Hong Kong Law Reform Commission; in South Africa: the South African Law Reform Commission; in Canada: the Law Reform Commission of Canada; and in the United Kingdom: the Law Commission in the United Kingdom.

³²¹ There are endless varieties of democracies too: O. Kahn-Freund, *On Uses and Misuses of Comparative Law*, 37(1) MOD. L. REV. 1, 11-12 (1974).

³²² See Hill, *Persistent Debate*, *supra* note 316, at 747.

³²³ Malaysia is an example. While some of its law, including common law precedents, is drawn from the United Kingdom, in practice the laws are not enforced because of Malaysia’s political considerations and its different market economy.

³²⁴ See Paul J. Omar, *The Emergence of a New European Legal Order in Insolvency*, INT’L COMPANY AND COM. L. REV. 262 (2004); Paul J. Omar, *Four Models for Rescue: Convergence or Divergence in European Insolvency Laws? Part I*, INT’L COMPANY AND COM. L. REV. 127 (2007); Paul J. Omar, *Four Models for Rescue: Convergence or Divergence in European Insolvency Laws? Part 2*, INT’L COMPANY AND COM. L. REV. 171 (2007); M. Cristina di Luigi, *An Invasive Top-Down Harmonisation or a Respectful Framework Model of National Laws? A Critique of the Societas Europaea Model*, INT’L COMPANY AND COM. L. REV. 58 (2008).

³²⁵ Hill gives the example of the transplantation of corporate governance laws to Russia in the 1990’s commenting upon the “conundrum of corporate governance—the fact that the transplantation of demonstrably good laws may be totally ineffective.” Hill, *Persistent Debate*, *supra* note 316, at 750.

A multitude of economic influences also drive similarity of laws. Access to the international market for capital can be a major motivating force for harmonization of laws, and the capital raising laws across the various jurisdictions outlined above provide evidence of this. A “Force of Example”³²⁶ argument also exists, whereby jurisdictions adopt the laws of successful economies, in an attempt to match their economic achievements. For example, Hansmann and Kraakman claim that the predominance of the shareholder primacy model will inevitably lead to widespread convergence of the institutions of corporate governance.³²⁷

The prevalence of multinational corporations and their desire to operate in acceptable regulatory environments is also a factor, as is the need for cross listing on foreign stock exchanges. The pervasiveness of international legal, accounting and consulting firms, as well as investment banks, can also lead to a demand for more homogeneity in corporate law.³²⁸ Not all economic influences, of course, lead to convergence of laws. It can in fact be more economically efficient to have different laws, to take advantage of local conditions.³²⁹ Some multinationals might deliberately seek to locate some of their operations in countries with more liberal laws than their original countries of incorporation, precisely to avoid certain stringent requirements, for example in relation to labor laws or emissions controls.

Practical considerations can mitigate against following the examples of legislative reform set by other countries. Inertia is a powerful force, because law reform of any kind, including convergence with other jurisdictions, generally requires legislative action, often following extensive and costly government consultation processes. The availability of alternative means of protecting a certain cohort of corporate stakeholders can also result in dissimilarities of laws, simply because the foreign laws are not required; on the other hand, where protection cannot be found through other means, such as contract, the “Force of Logic”³³⁰ can drive relevant stakeholders to seek a superior method of protection, often borrowed from another jurisdiction.

³²⁶ Hansmann & Kraakman, *supra* note 313, at 450.

³²⁷ According to Hansmann and Kraakman, “[t]here are three principal factors driving consensus on the standard model: the failure of alternative models; the competitive pressures of global commerce; and the shift of interest group influence in favor of an emerging shareholder class.” *Id.* at 443.

³²⁸ *Id.* at 449.

³²⁹ *Id.* at 464.

³³⁰ *Id.* at 449.

The evolution of local laws and path dependence³³¹ can have a marked effect on the adoption of laws originating in other jurisdictions. The similarities of laws amongst Commonwealth countries demonstrate their common ancestry, but they also owe much to similarities in culture, property rights, parliamentary and judicial systems, accounting standards and a variety of other supporting mechanisms. Scholars refer to this as “complementarities,”³³² where laws which fit well with a broad range of local institutions are likely to survive.³³³

Kahn-Freund points to the degree of adjustment required to suit the laws’ new home and the chances of rejection of the transplant, making an analogy between the transplantation of a kidney from one body to another and of a carburetor from one car to another.³³⁴ Any particular instance of transplantation of laws is a point on this continuum from kidney to carburetor, and is affected by the political, economic, practical, and evolutionary factors outlined above. Kahn-Freund also points to environmental factors such as increasing industrialization, urbanization, worldwide communications and the ease of movement of people as contributing to a more homogenous world for law, including corporate law.³³⁵

Of course, the issue of convergence and divergence of laws across jurisdictions needs to be considered against the background of the need for laws to grow and develop within jurisdictions. Each individual instance of legal evolution, especially in response to the political and economic needs of the particular country as noted above, has the capacity to bring further diversity to laws.³³⁶

³³¹ In relation to corporate governance, see L. Bebchuk & M. J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52(1) STAN. L. REV. 127 (1999).

³³² *Id.* at 140. See R. H. Schmidt & G. Spindler, *Path Dependence, Corporate Governance and Complementarity*, 5(3) INT’L FIN. 311 (2002).

³³³ Conversely, laws which are inconsistent with their local environment, possibly because they were transplanted from a jurisdiction with different norms, are less likely to be successful or remain in their original form. Schmidt and Spindler note that the cost of changing laws or institutions may outweigh the possible efficiency or welfare gain which the change is intended to achieve. See Schmidt & Spindler, *supra* note 332, at 314. There needs to be a commitment to maintain the newly introduced laws, which, by definition, did not originate organically from that country, and therefore are arguably unlikely to be a “natural fit.” Bebchuk and Roe describe the tendency to revert to prior practice as “persistence.” Bebchuk & Roe, *supra* note 331, at 136. Schmidt and Spindler stress that “a local optimum may be different from a global optimum. What constitutes the nearest, and seemingly most attractive, local optimum depends on the starting point at which a given biological or social system happens to be at a given point in time.” See Schmidt & Spindler, *supra* note 332, at 315.

³³⁴ Kahn-Freund, *supra* note 321, at 5-6.

³³⁵ *Id.* at 9.

³³⁶ Katharina Pistor notes that “[t]he corporation has been a remarkably resilient institution for 200 years of industrialisation and modernisation largely because of its capacity to adapt constantly to a changing environment.” Pistor et al., *supra* note 319, at 793-94.

This Part has sought to examine briefly why laws may be similar or different across jurisdictions. It does not seek to conclude whether they *should* be similar or different. What is apparent from the examination of the six areas of law in this article is that similarity of laws is associated with the considerable protection of powerful corporate stakeholders—shareholders and revenue authorities, as well as the conspicuous environment lobby—whereas leniency of laws as well as diversity of laws have a degree of correlation with vulnerable and often forgotten stakeholder cohorts—unsecured trade creditors, employees and tort creditors.

The fact that stringent laws correlate with widespread international similarity, and conversely that lenient laws correlate with widespread dissimilarity, perhaps should come as no surprise. Arguably, the reasons behind their stringency underpin their adoption throughout the jurisdictions examined. For example, many jurisdictions have laws requiring directors to pay the unremitted taxes of their companies at the time of corporate insolvency. It is unsurprising that protecting the national revenue base is a major political consideration throughout the world, and that similar measures providing against corporate default in this context are embraced across many jurisdictions.

Likewise, the extensive acceptance of similar capital raising laws reflects the globalization of the international securities market and the need to ensure the confidence of shareholders. Common or similar laws in relation to the protection of the environment demonstrate the effectiveness of national and international lobby groups. It also shows recognition by governments that the protection of the environment is important for political and economic reasons, as well as for its own sake.

In contrast, the protection of vulnerable stakeholder groups³³⁷—unsecured trade creditors, employees and tort claimants—is internationally diverse. Employees generally benefit from unemployment benefits and sometimes from government schemes, which takes much of the impetus away from calls to hold directors personally liable for their unpaid entitlements. Trade creditors get relatively little sympathy from courts and legislators, and are expected to protect themselves through a variety of measures such as diversification and through pricing their goods and

³³⁷ See also J. Lipson, *Directors Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189, 1193 (2003). Interestingly, Lipson includes taxing authorities in his description of “low VCE creditors.” These are parties who “lack volition, cognition and exit.” This describes creditors who lack voluntariness in their dealings with the company (tort creditors, taxing authorities, terminated employees); lack information (cognition) about the true state of company affairs; and lack the ability to exit from these relationships because of the absence of a market to sell their rights against the company.

services to self-insure against loss. A disparate group, they lack the political power to lobby for a better deal. Likewise, tort creditors lack a common voice to call for legislative protection, in the event of corporate insolvency.

This leads to a simple hypothesis—that the forces which have resulted in stringent laws within a country are the same as those which lead to convergence internationally. The converse applies equally—the forces which have brought about a tepid response to protection of a stakeholder group within a country tend to produce laws which are not likely to be emulated internationally.

Another, perhaps cynical, observation can be drawn from the examination of the laws in Parts II and III. It is that when legislators are committed to defending a particular institution—in particular, the revenue base and the securities market—the laws they pass can be quite draconian, with very little opportunity for directors to escape liability. There is no apparent fear that the imposition of liability will make directors risk averse, to the detriment of their companies and the economy, or that talented businesspeople will be reluctant to accept directorships with such a harsh liability regime.

This sort of argument, in Australia at least, appears to be reserved for discussions of liability in relation to insolvent trading or the protection of employee entitlements,³³⁸ yet it has been shown above that these are two of the least generous forms of protection available to corporate stakeholders. Australia's new government is raising the issue again,³³⁹ and it will be interesting to see what forms of directorial liability come under the closest scrutiny in this regard.

V. CONCLUSION

Jurisdictions throughout the world lift the corporate veil to impose liability on directors for corporate faults and defaults. A range of jurisdictions and six areas of law were chosen here for comparison. There is widespread similarity in the laws relating to capital raising, and also

³³⁸ Byrne has argued that: “the more serious cost is the effect the liability regime will have on the performance of the director. Their inability to efficiently cope with the liability would logically mean further incentive to avoid the riskier ventures which raise the potential losses. It is this cost which may be seen to be of significant social consequence. It is extremely difficult to measure the size of such cost and, therefore, whether or not it will outweigh the benefits to creditors” Mark Byrne, *An Economic Analysis of Directors' Duties in Favour of Creditors*, 4 AUSTRALIAN J. CORP. L. 275, 283 (1994). See also Victor Yeo & Joyce Lin, *Insolvent Trading—A Comparative and Economic Approach*, 10 AUSTRALIAN J. CORP. L. 216, 234 (1999); David B. Noakes, *The Recovery of Employee Entitlements in Insolvency*, in COMPANY DIRECTORS' LIABILITY FOR INSOLVENT TRADING 129, 139 (I. Ramsay ed., 2000).

³³⁹ See Henry, *supra* note 2.

considerable overlap in laws relating to the recovery of unremitted taxation installments and protection of the environment. On the other hand, there are noticeable dissimilarities among insolvent trading laws, recovery of employee entitlements and protection of tort creditors.

This illustrates two points: that there are many ways in which to legislate to achieve similar objectives, and that, in certain areas, some governments do not consider legislation to be required, whereas others consider it necessary.

While there are many reasons for convergence and divergence of laws, based on political, economic, practical and evolutionary reasons, a pattern is suggested from the areas of law examined—that areas of stringent liability on directors broadly, but not precisely, correspond with widespread international adoption of similar laws, and conversely that more lenient laws are unlikely to be copied internationally. In other words, even where formats differ, governments appear to agree on which questions of law require a firm legislative response, and which do not. Whether these assessments are correct is a matter for other research.³⁴⁰

³⁴⁰ See Helen Anderson, *Corporate Social Responsibility—the Case for Unsecured Creditors*, 7(1) OXFORD UNIVERSITY COMMONWEALTH LAW JOURNAL 93–124 (2007); Anderson, *Directors' Liability for Unpaid Employee Entitlements*, *supra* note 85.